# The Regulation of Marketplace Lending

## A Digest of the Principal Issues

November 2025 Update

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# THE REGULATION OF MARKETPLACE LENDING:

## A Digest of the Principal Issues

November 2025 Update

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# Preface

We are pleased to offer once again our update of the principal regulatory and securities issues applicable to marketplace lending and related legal issues. Coming out of the 2024 election cycle, the regulatory landscape is seeing an "about-face." While the Biden years brought robust enforcement primarily by the Consumer Financial Protection Bureau (*"CFPB"*), from the early days of the second Trump administration, curtailing if not dismantling the CFPB seems to be on the horizon.

As in past updates, we have no shortage of topics to discuss, given both significant legislation and regulatory initiatives that reflect the industry's growing importance in the financial markets. Most notably, true lender litigation continues. Buy Now Pay Later, Earned Wage Access, and other similar innovative products have come on the scene, navigating into regulatory headwinds, and new regulations and a proliferation of state laws continue to impact the industry, including attempts to "opt out" of federal preemption and impose state limitations on programs of banks supported by fintechs. We discuss these and other important developments that have occurred since the November 2024 publication in the "Recent Developments in Marketplace Lending Regulation" section that immediately follows this Preface. The remainder of this book then describes in greater detail the status of marketplace lending under existing consumer protection and other applicable laws. We have changed the name of this publication from a "summary" of the principal issues to a "digest" of those issues since we discuss an overview of issues as well as their historical development and current status.

Since marketplace lending was born out of innovation, we have added a new section dealing with recent innovations related to digital assets including cryptocurrency as part of our "Recent Developments in Marketplace Lending Regulation" section. In addition to summarizing current events in this area, we also attempt to provide insight on how these new arenas impact the now more conventional marketplace lending space.

Given that the securities law implications on marketplace lending have diminished, the largely historical references to seminal programs have been placed in an appendix for reference which is now only going to be available on our website: www.chapman.com.

At the outset, it may be helpful for us to discuss briefly the scope of this book and some of the terminology we use. There is no single or universally accepted definition of "marketplace lending." In general, though, marketplace lenders can be viewed as companies engaged in an Internet-based lending-related business (other than payday lending) that are not banks or savings associations or otherwise regulated as financial institutions. They may offer a wide variety of financial products, including student loans, small business loans, and real estate loans, in addition to the unsecured installment consumer loans on which the industry initially and has largely focused. However, "marketplace lenders" may or may not actually be lenders. This term is a generic term to identify participants in marketing, originating, selling, purchasing, and servicing loans. They also may fund their loans through a variety of means, including equity capital, commercial lines of credit, sales of whole

loans to institutional investors, securitizations, and/or pass-through note programs. In this book, we focus on the consumer lenders since they are the most heavily regulated and have the highest loan volumes. However, much of the discussion herein—outside of matters pertaining directly to consumer lending regulation—will also apply to non-consumer lenders. In fact, multiple states have passed commercial lending statutes requiring disclosures for commercial loans similar to what is done in the consumer lending space, which we discuss.

Some marketplace lenders solicit borrowers to take loans that are actually made and originated by FDIC-insured financial institutions. For these types of programs, we refer to the bank that serves as the originating lender as the "Funding Bank." The marketplace lenders are often service providers to the financial institution. The Funding Bank structure (sometimes called the bank partnership model) has generated legal challenges, as discussed in this book, particularly where the marketplace lender both solicits and then purchases and services the loans that are originated by the Funding Bank. Other marketplace lenders obtain state licenses in order to make loans directly to borrowers under state laws.

In some instances, we refer to marketplace lenders as online lenders or "platforms," since by definition such lenders provide their services through Internet-based platforms.

Of course, regardless of its source of funding, any prospective operator of an Internet lending platform must be careful to plan and operate its business in compliance with applicable laws and regulations. Regulatory costs have proven to be a significant barrier to entry in this industry; such costs will remain a significant expense for those platforms that commence operations, and any failure by a platform operator to comply with applicable laws and regulations can result in civil or criminal penalties, litigation expense, adverse publicity, or, in an extreme situation, the termination of its business. In this regard, we hope that our resource will help lenders and other market participants understand the key legal and regulatory issues facing them.

We must caution that this publication is intended only to identify the principal laws and regulations that apply to Internet-based lending. In most instances, we provide only a digest and summary of those laws and related issues and much more could be said of any particular area. We further caution that this document does not provide detailed guidance on the steps required to comply with any particular law or as to the laws that may apply to any particular marketplace lender or program. Participants in the industry should consult with counsel on their particular situation and program.

# Recent Developments in Marketplace Lending Regulation

## I. WHAT A DIFFERENCE A YEAR MAKES!

At the time of our last update late last year, there was a flurry of activity from the then-Biden federal administration, including almost daily promulgations from the activist Consumer Financial Protection Bureau (*"CFPB"* or *"Bureau"*). The November 2024 elections resulted in both houses of Congress being in Republican hands with a Republican president in the White House. Soon after the inauguration of President Trump in January 2025, the regulatory climate reversed course through the ushering in of new leadership at the federal regulatory agencies, the dismantling of the consumer watchdog CFPB, and the embarkment on an era of purported deregulation. In this segment, we will not discuss all of those changes but will concentrate on ones that affect the regulation of the marketplace lending industry.

### A. New Agency Leadership

Soon after the new administration took office, leadership changes were made at the federal banking agencies and the CFPB.

On Inauguration Day, January 20, 2025, Travis Hill became Acting Director of the Federal Deposit Insurance Corporation (*"FDIC"*) upon the resignation of Martin Gruenberg.[1] In September 2025, the President nominated Mr. Hill to become the Director of the FDIC. With respect to the Office of the Comptroller of the Currency (*"OCC"*), Rodney Hood served as Acting Comptroller from February 10, 2025, until July 15, 2025, when Jonathan Gould began a five-year term as Comptroller. The President also fired two of the three members of the National Credit Union Administration. They have sued for reinstatement but the court has not allowed them to remain in their positions during the pendency of the litigation. The Federal Trade Commission is down two members, both fired by President Trump, and is now acting with only three commissioners, all Republicans. The fired commissioners have also brought suit against the President, but courts have ruled that they cannot continue to serve pending the outcome of the litigation.

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1 Mr. Gruenberg resigned but had been the subject of reports of a toxic workplace at the FDIC. Former President Biden had previously nominated another person for the chair spot, but the Senate did not confirm the nomination before the change in administration.

The normally staid Board of Governors of the Federal Reserve System (*"Federal Reserve"*) has been in the spotlight. President Trump has badgered Board Chair Jerome Powell, threatening to fire him for not cutting interest rates and criticizing him for expenditures on renovations of the Federal Reserve's offices. In late August 2025, in an unprecedented move, President Trump fired Federal Reserve Governor Lisa Cook for alleged fraud on a mortgage application. Ms. Cook sued and was allowed to remain in office pending the outcome of the litigation, which will be decided by the United States Supreme Court.[2] In September 2025, the Senate confirmed the appointment of President Trump's nominee, Stephen Miran, to the Federal Reserve. At its September 2025 meeting, the Federal Reserve voted to cut interest rates.

No stranger to controversy is the leadership at the CFPB. On February 1, 2025, former Director Rohit Chopra was fired and replaced temporarily by Scott Bessent, the Secretary of the Treasury. On February 7, 2025, President Trump named Russell Vought, who also serves as Director of the Office of Management and Budget, as Acting Director of the agency.[3] Mr. Vought instructed all CFPB employees to halt any work until it had been reviewed by the new administration, and he closed the headquarters building. The Department of Government Efficiency reviewed records at the CFPB, and the budget bill passed by Congress cut the budget of the CFPB essentially in half. Unions representing the CFPB employees have brought suit in federal court. While a district court granted a temporary injunction against the mass layoffs, a federal appeals court reversed that decision, allowing reductions in force to be carried out while the lawsuit is being litigated. Certain actions of the CFPB affecting the marketplace lending industry are outlined below.

Collectively, the clear implication is that deregulation will be the hallmark of this administration, even if it creates some degree of uncertainty.

### B. New Guidance, Rule Reversals, and Rescission of Guidance at CFPB

Several recent actions of the current CFPB may have an effect on marketplace lending participants. These include new guidance, reversals of prior rulemaking, and the rescission of pre-existing guidance. The agency has also terminated or reconfigured enforcement actions. However, even if enforcement will be curtailed at the federal level, state attorneys general have power to enforce consumer protections under both federal law and their own state statutes. Some of the more significant recent CFPB actions are discussed below.[4]

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2 The Supreme Court is allowing Ms. Cook to remain in office and will hear oral arguments on the case in January 2026.

3 At one point, the administration nominated Andrew McKiernan to be CFPB Director but later withdrew his nomination, leaving Mr. Vought as the Acting Director.

4 Many of these are part of the Regulatory Agenda published by the CFPB in September 2025. Despite a reduced headcount at the agency, the agenda contains the largest number of items ever put forth by the CFPB. The agency will be working on some 24 matters through May 2026. The agenda includes matters where the CFPB is considering a rule (pre-rule stage), proposed rules, and final rules.

### *1. CFPB to Limit Non-Bank Enforcement Activity to Significant Consumer Harm*

The Consumer Financial Protection Act (*"CFPA"*) allows the CFPB to supervise non-banks that pose risks to consumers.[5] This authority was largely unused until April 2022, when the prior leadership indicated that it would invoke this dormant authority to supervise non-banks. Previously there was no rule or definition of what constituted risk to consumers, making actions by the agency discretionary on a case-by-case basis. On August 26, 2025, the CFPB issued a proposed rule that seeks to define what constitutes the type of risk that would trigger CFPB supervision of a non-bank.[6] The proposed rule would define conduct that poses risks to consumers as that which (1) presents a high likelihood of significant harm to consumers and (2) is directly connected to the offering or provision of a consumer financial product or service.[7] The agency stated that this particular standard was needed in order to avoid inconsistent application of the statute through individual orders. Viewed as a higher standard, this will have the effect of narrowing the supervisory authority of the Bureau and limit the number of non-banks that would be supervised.[8]

### *2. Repeal of Bad Actor Registry and Form Contract Terms Registry*

One of the chief tenets of the Chopra-led CFPB was to focus attention on bad actors and particularly on recidivists to detect and deter practices deemed unfriendly to consumers. In 2022, the CFPB established a "repeat offender" unit which made targeting repeat offenders a key priority. In June 2024, the CFPB established a registry to highlight non-bank offenders that were subject to government or court orders for violating consumer protection laws.[9] The rule became effective on September 16, 2024. The public registry was criticized as being unfair to non-banks since supervisory information about banks was not always public and the registry would increase compliance costs, and lawsuits against the listed companies would proliferate. In April 2025, the Bureau issued a press release stating that it was considering elimination of the rule and that it would not prioritize either enforcement or supervisory actions related to companies' failure to submit annual reports by the required deadlines. In May 2025, the CFPB published notice of its intended rescission of the rule requiring non-banks to file public orders

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5 12 U.S.C. 5514(a)(1)(C). The statute allows such supervision where "… the Bureau has reasonable cause to determine, by order, after notice to the covered person and a reasonable opportunity for such covered person to respond, based on complaints collected through the system under section 5493(b)(3) of this title or information from other sources, that such covered person is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services."

6 90 Fed. Reg. 41,520 (Aug. 26, 2025).

7 The CFPB requested public comment on this proposal and specifically whether risks to consumers must be potential violations of law, a concept it had not included in the proposed rule. The comment period closed on September 25, 2025.

8 Most of the exams by the CFPB have been related to non-banks. This CFPB wants to restore supervision focused on larger financial institutions and this rule seems to further that objective.

9 "Registry of Nonbank Covered Persons Subject to Certain Agency and Court Orders," 89 Fed. Reg. 56028, 56067 (July 8, 2024).

issued against them and to file annual reports certifying compliance with the reported orders.[10] The agency noted concerns that the costs of the registry were not justified by speculative and unquantified benefits to consumers. On October 29, 2025, the CFPB officially rescinded the "Registry of Nonbank Covered Persons Subject to Certain Agency and Court Orders" rule.

Also on October 29, 2025, the CFPB withdrew a 2023 proposal that would have established a "Registry of Supervised Nonbanks That Use Form Contracts to Waive or Limit Consumer Legal Protections." Under the registry, supervised non-banks would have been required to submit information about provisions in consumer credit contracts that waive or limit consumer protections. This would have included things like arbitration clauses, limitation of liability, and waiver of class actions. The CFPB determined that the cost of compliance for this rule would not justify speculative or uncertain consumer benefits. The withdrawal of both of these proposed registries suggests that the focus of the current CFPB is moving away from non-banks, unlike the prior agency leadership, which wanted broader public reporting of non-bank activity.

However, in January 2025 only days before the new administration was sworn in, the prior CFPB issued a proposed rule that would prohibit certain provisions in consumer contracts, including opt-outs of federal or state laws, unilateral amendments, and confessions of judgments. Public comments were due in April 2025. Given the prior rulemakings, this rule may also be subject to withdrawal by the CFPB.

### *3. Rescission of Prior Guidance*

In May 2025, the CFPB continued its revisionist bent toward lessening regulatory burdens and rescinded some 67 pieces of guidance previously issued by the CFPB, claiming that some might even be contrary to federal law. These included 8 policy statements, 7 interpretive letters, 13 advisory opinions, and 39 circulars and bulletins. Acting Director Vought noted that many of these came into being outside of the notice and comment rulemaking process. He indicated that the Bureau would issue guidance only when necessary and where compliance burdens would be reduced. The action came after Mr. Vought had instructed staff to review all guidance issued since the inception of the CFPB in 2011. However, Mr. Vought also instructed staff to continue their review of the rescinded guidance, suggesting reinstatement could occur. Interestingly, one of the rescinded circulars related to unfair and deceptive acts and practices involving non-mortgage products offered by digital platforms, but the Bureau did not rescind similar guidance related to mortgage loans made by digital platforms and service providers, possibly suggesting that the mortgage arena could be a focus for regulatory activity.

10 "Registry of Nonbank Covered Persons Subject to Certain Agency and Court Orders; Proposed Recission," 90 Fed. Reg. 20406 (May 14, 2025).

### *4. Buy Now Pay Later (BNPL) Rule Won't Be Enforced*

In May 2024, the CFPB issued a BNPL interpretive rule that went into effect on July 30, 2024. The rule essentially made many BNPL programs subject to credit card rules and various Truth in Lending requirements applicable to open-end credit products.[11] The rule was challenged in court by the Financial Technology Association as violative of the Administrative Procedure Act, which requires a notice and comment process.[12] The trade group claimed that the CFPB exceeded its scope of authority by imposing obligations on BNPL not contemplated by the Truth in Lending Act or its implementing Regulation Z. In May 2025, the CFPB issued a statement that it would not make enforcement of the BNPL rule a priority. The statement also indicated that the Bureau is considering rescission of the BNPL rule. Such actions are consistent with a filing made in a status report on a motion to stay the Financial Technology Association lawsuit, where the CFPB told the court it was planning to revoke the BNPL rule. As a result, the lawsuit was stayed. In June 2025, the CFPB stated to the court that it would not issue a new or revised BNPL rule.[13]

### *5. Larger Participant Rule*

Section 1024 of the CFPA provides that the CFPB has supervisory authority over certain non-banks and over larger participants that the CFPB defines under its rules.[14] Previously, the CFPB has issued six rules defining larger participants subject to CFPB supervision. These include student loan servicers, general-use payment application providers (voided by Congress),[15] consumer reporting agencies, international money transfer providers, debt collectors, and automobile financing. In August 2025, the CFPB requested public comment on four proposed rules that would significantly reduce the number of non-bank companies that the CFPB would supervise in the credit reporting, money transfer, debt collection, and auto finance sectors. The Bureau indicated that it believed the benefits of the current structure do

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11 The rule found that BNPL constituted a digital user account, which constituted a credit card. BNPL providers were then deemed to be credit card issuers and the programs subject to rules applicable to credit cards. The current position is that these requirements do not apply to BNPL products.

12 *Fin. Tech. Ass'n v. Consumer Fin. Prot. Bureau*, Case No. 1:24-cv-02966 (D.D.C. filed Oct. 18, 2024). A rulemaking requires notice and comment, but an interpretive rule does not.

13 The CFPB based its stance on the position that the prior rule was defective in that it applied open-end credit rules to BNPL products which are typically structured as closed-end loans. In addition, the Bureau stated that the prior rule provided little benefit to consumers and put a substantial burden on BNPL providers.

14 Covered persons for purposes of this section include entities involved in real estate secured lending (origination, brokerage or servicing, and related modification or foreclosure services), private education lending, and payday lending.

15 On November 21, 2024 (*i.e.,* after the 2024 elections), the CFPB enacted a rule effective January 9, 2025, that would extend the Bureau's supervisory authority over large digital funds transfer and digital payment wallet applications. Following President Trump's inauguration, Congress revoked the rule under the provisions of the Congressional Review Act that allows for the rescission of an agency rule enacted within a certain time prior to the new Congress being installed. President Trump then signed the revocation and the rule became null and void.

not justify the compliance burdens placed on those entities. The comment period for these proposed rules ended on September 22, 2025.

### *6. Credit Card Late Fees Rule Vacated*

On March 5, 2024, the CFPB enacted a rule that reduced the late fees that could be charged on credit cards by large card issuers from $30 (for the first default) and $41 (for subsequent defaults) to a flat $8 fee and not subject to inflationary increases under 12 C.F.R. 1026.52(b). This rule was challenged in court.[16] In a joint motion for entry of a consent judgment in April 2025, the CFPB settled the lawsuit and vacated the credit card rule. Accordingly, the prior fee limits remain in effect.

### *7. Open Banking Rule Stayed and Awaiting New Proposal*

In October 2024, the CFPB issued its long-awaited "open banking" rule promulgated under Section 1033 of the Dodd-Frank Act.[17] The initial rule provided that financial institutions must provide consumers with the ability to access and transfer their financial data to authorized third parties at no cost. The open banking rule was intended to foster competition and innovation by giving consumers more choices. Almost immediately after the rule was released, it was challenged in federal court.[18] On July 20, 2025, the CFPB filed a motion to stay the case, stating that it was initiating a new rulemaking to reconsider and substantially revise the prior rule. The court granted the motion to stay. The CFPB told the court that issuance of the rule was beyond the statutory authority granted to the CFPB. The CFPB argued that while the statute allows consumers to access their own data, the rule would mandate sharing, which is not in the statute. The agency further stated that to give such broad authority to the CFPB violates the Administrative Procedure Act. The rule would also prohibit the charging of fees for obtaining information, although the statute does not require this. The plaintiffs filed for an injunction on the basis that they would suffer harm if the rule went into effect while the bureau was reconsidering it. On October 20, 2025, the Kentucky district court hearing the case granted a motion for a preliminary injunction, delaying the compliance dates until the CFPB can reconsider the rule. Accordingly, the CFPB will seek additional input and public comment to determine an approach to the topic of open banking. The law does, however, require the CFPB to issue a rule on this topic.

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16 *Chamber of Commerce of the United States of America v. Consumer Fin. Prot. Bureau,* Case No. 4:24-cv-213-P (N.D. Tex.). While the rule only affected large issuers, some of these larger issuers were involved with marketplace lending programs that offered credit card products.

17 12 U.S.C. 5533, known as Section 1033 **[of the CFPA of 2010, which is part]** of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

18 *Forcht Bank, N.A., Ky. Bankers Ass'n and Bank Policy Inst. v. Consumer Fin. Prot. Bureau*, Case No. 5:24-cv-00304-DCR (E.D. Ky.).

### *8. Section 1071 Small Business Data Collection Rule to Be Reconsidered*

Section 1071 of the Dodd-Frank Act requires the CFPB to promulgate a small business data collection and reporting rule, ostensibly to determine whether discrimination in small business lending was occurring. Following the passage of the Dodd-Frank Act in 2010, it took the CFPB over ten years to publish a rule, which was pushed along by a community group lawsuit seeking to require the Bureau to actually promulgate the rule. In May 2023, the rule was finally published—and then promptly challenged in court.[19] The rule required the collection of dozens of data points on small business loan applications and created a reporting scheme with respect to that collection. The district court supported the CFPB, and the case was then appealed to the Fifth Circuit, where the appellate court stayed compliance with the rule for many financial institutions.[20] Other court challenges occurred, including in Florida.[21] While the Florida court initially ruled in favor of the CFPB, a motion to stay was before the court and the CFPB's response to the motion told the court that the CFPB under its new leadership would initiate a new rulemaking under Section 1071, which it anticipated to be less restrictive than the prior rule.[22] In May 2025, the CFPB stated that it would not make enforcement of the Section 1071 rule a priority. Under the prior rule, compliance and reporting requirements were to begin in late 2024, extended in 2024 by an interim final rule. In June 2025, the CFPB issued another interim final rule that extended the compliance dates even further, to July 2026 for some lenders and 2027 for other lenders. This interim final rule was made a final rule in October 2025 and becomes effective December 1, 2025.[23] To complicate this matter, a suit has been brought by community action groups against the CFPB to force the agency to implement the rule.[24]

### *9. Medical Debt Reporting Rule Vacated/FCRA Interpretive Rule Issued*

Just days before Inauguration Day in January 2025, the CFPB still under the Biden administration issued a rule that would bar unpaid medical bills from appearing on consumer reports and would prohibit lenders from using that information in the credit underwriting process. The rule was to take effect on March 17, 2025. Again, lenders and the trade group representing credit reporting agencies challenged

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19 *Texas Bankers Ass'n v. Consumer Fin. Prot. Bureau,* Case No. 7:2023-cv-00144 (S.D. Tex.).

20 Case No. 24-49705 (5th Cir. 2025).

21 *Revenue Based Finance Coalition v. Consumer Fin. Prot. Bureau,* Case No. 23-24882 (S.D. Fla.).

22 The rule has always been somewhat controversial. During the Biden administration, both houses of Congress voted to repeal the rule under the Congressional Review Act, but the repeal was vetoed by President Biden. Legislation has also been introduced in Congress to repeal the underlying section of the Dodd-Frank Act. H.R. 976 to this effect was approved by the House Financial Services Committee.

23 90 Fed. Reg. 47514 (Oct. 2, 2025).

24 *Rise Economy et al. v. Vought*, Case No. 1:25-cv-02374 (D.D.C. filed July 23, 2025). In October 2025 the plaintiffs filed a motion for summary judgment in the action.

the rule in court.[25] The plaintiffs claimed that the agency had exceeded the authority granted to it under the Fair Credit Reporting Act ("*FCRA*"). After the change in leadership at the CFPB, upon a Joint Motion for Consent Judgment, in July 2025, the court agreed to vacate the rule. As a result, medical debt information can continue to appear on credit reports and be used by creditors to determine creditworthiness.

However, some 15 states have enacted laws prohibiting the use of medical debt on credit reports. This approach may have been encouraged by an interpretive rule issued by the CFPB in 2022 that found the preemption of state law under the FCRA to be narrow, thus allowing the states with greater ability to regulate credit reporting. That rule was rescinded earlier in 2025. On October 28, 2025, the CFPB issued a new interpretive rule finding broad federal preemption under the FCRA as being consistent with Congress's intent to create national standards for the credit reporting system. In particular, the issuance stated that the prior rule was wrong to conclude that states could regulate the categories of information on consumer reports, such as medical debt, arrest records, rental arrears, or convictions. The current CFPB's view is that most state laws attempting to regulate the subject matter of consumer reports are preempted. As a result, state laws prohibiting medical debt reporting are subject to challenge.

### *10. Dismissal of Fair Lending—UDAAP Examination Guideline Lawsuit*

The CFPB in 2022 snuck into its UDAAP examination manual a provision that would make fair lending violations an unfair and deceptive practice. This insertion was challenged in federal court.[26] The challenge was based on the argument that the fair lending laws already provided for remedies for violations and, therefore, there should not be additional legal liability as an unfair practice. In addition, the suit alleged that there was no notice or comment on the change and that the CFPB did not have the authority to legislate such a rule. The court agreed and granted summary judgment vacating the addition to the exam manual. The CFPB appealed to the Fifth Circuit.[27] On April 30, 2025, the Fifth Circuit granted a Joint Stipulation to Dismiss entered into by the CFPB and the plaintiffs, which ended the lawsuit and eliminated the reference to fair lending violations being a UDAAP.

### *11. Enforcement Actions*

Soon after the new federal administration took office in January 2025, the CFPB began reviewing enforcement actions. Some 20 actions have been dismissed. Other enforcement actions have been suspended, vacated, or overturned. In one instance, a court refused to accept the unwinding of a prior enforcement action that had been reduced to judgment.[28]

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25 *Cornerstone Credit Union League et al. v. Consumer Fin. Prot. Bureau*, Case No. 4:25-cv-00016 (E.D. Tex.).

26 *Chamber of Commerce of the United States of America et al. v. Consumer Fin. Prot. Bureau*, Case No. 6:22-cv-381 (E.D. Tex.).

27 Case No. 23-40650 (5th Circ. 2025).

28 *Consumer Fin. Prot. Bureau v. Townstone Mortgage, Inc.*, Case No. 1:20-cv-04176 (N.D. Ill.). This case dealt with fair lending issues in the context of radio content that discouraged applicants in protected classes. The Seventh Circuit ultimately ruled

As to fintechs, in at least one instance a court enforcement action was dismissed, while in another the CFPB is continuing to prosecute the case. In May 2024, the CFPB sued Solo Funds, Inc.[29] The Bureau alleged that claims of "no interest" were deceptive because the company asked for tips and donations which, if provided by consumers, would result in rates exceeding 36% APR. Related claims were made as to collection of otherwise void loans. In February 2025, however, the CFPB dismissed the action. A different result occurred in an action against another fintech, MoneyLion.[30] In this instance, the CFPB accused MoneyLion of overcharging service members in violation of the Military Lending Act. In February 2025, the new leadership at the CFPB announced that the agency would continue prosecuting this action. This may be an indication that violations that affect military service members will be a priority even in this new era of deregulation and less strict enforcement.

As of the date of this writing, the CFPB under the second Trump administration has only filed two enforcement actions, one of which is against a financial technology provider, Synapse Financial Technologies, Inc.[31] Synapse provided proprietary software that served as a go-between for traditional banks that had programs with non-bank fintech service providers, which was intended to keep track of customer funds in various platform programs. In April 2024, Synapse filed for bankruptcy, and it soon became obvious that discrepancies in record keeping practices left some consumers without access to their funds or, notably in some instances, that funds were missing. Compounding the problem was that Synapse worked with at least three banks offering cash programs offered by fintech platforms, and Synapse directed the movement of customer funds between the banks. However, the funds the banks were actually holding for consumers were far less than reflected in the records of Synapse by some $60 to $90 million. The CFPB alleged that Synapse violated the CFPA by failing to maintain adequate records of customer funds and failing to ensure that the records matched those of the partnering banks, which also caused the loss of access to those funds.[32] On September 12, 2025, the court entered a Stipulated Final Judgment and Order that provided for injunctive relief, a prohibition on the sale of customer

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that fair lending laws (the Equal Credit Opportunity Act in particular) applied to prospective applicants as well as actual applicants. The CFPB felt that Townstone had been unfairly picked out and prosecuted for a small amount of radio content and sought to undo the prior settlement.

29 *Consumer Fin. Prot. Bureau. v. Solo Funds, Inc.*, Case No. 2:24-cv-4108 (C.D. Cal.).

30 *Consumer Fin. Prot. Bureau v. MoneyLion Techs., Inc.*, Case No. 1:22-cv-08308-JPC (S.D.N.Y.). In early October 2025, the city of Baltimore also sued MoneyLion for violation of consumer protection laws and misrepresenting high interest loans as instant cash advances, allegedly trapping low income residents into a cycle of debt. *Mayor & City Council of Baltimore v. MoneyLion Technologies Inc.*, Case No. C-24-cv-25-08340 (Cir. Ct. Baltimore City, Md.). In July 2025, the CFPB entered into a settlement with First Cash, Inc., also for Military Lending Act violations.

31 *Consumer Fin. Prot. Bureau v. Synapse Fin. Techs., Inc.*, Adv. No. 1:25-ap-01052 (Bankr. C.D. Cal.).

32 The banks involved have also been subject to litigation. *See, e.g., Espinola v. Evolve Bank & Trust et al.*, Case No. 1:23-cv-00075 (D. Colo.). Also sued were American Bank, Inc., AMG National Trust, Evolve Bancorp, Inc., and Lineage Bank. Allegations include negligence, theft, and breach of contract. The claims state that the banks did not maintain accurate ledgers and that customers do not have access to their funds.

information, and a $1 civil money penalty. The imposition of the slight civil money penalty, however, will allow the CFPB to access the civil penalty fund to reimburse consumers for lost funds.[33]

Given staffing cuts and a largely deregulatory agenda, the enforcement posture on an ongoing basis remains uncertain. In the first Trump administration, there were several enforcement actions filed, but penalties were not viewed as being large or harsh in most instances. But lest participants in the industry get too comfortable with what is happening at the CFPB vis-à-vis enforcement, it must be remembered that the Dodd-Frank Act allows state attorneys general and regulators to enforce the provisions of the CFPA.[34]

## C. Other Agency Actions with Potential Impact

### *1. Agency Dismantling of Disparate Impact*

In April 2025, President Trump issued an Executive Order mandating the elimination of disparate impact liability across federal agencies and claiming that disparate impact liability forces companies to "engage in racial balancing to avoid potentially crippling legal liability."[35] Primarily related to the Fair Housing Act and the Equal Credit Opportunity Act, disparate impact was a theory used to prove discrimination against protected classes under those laws. Simply put, disparate impact is where a factor, policy, or practice that is neutral on its face could nevertheless have a discriminatory effect on a protected class. Thus, disparate impact also was referred to as being the "effects test."

In July 2025, following the issuance of this Executive Order, the OCC announced that it would cease supervising institutions for disparate impact violations and removed references to the term from its lending examination manual.[36] Soon thereafter in August 2025, the FDIC similarly indicated that it would no longer examine for disparate impact under the fair lending laws and would limit its activities to disparate treatment.[37] It too removed references to disparate impact from its examination manuals.

While the primary federal banking regulators may have shifted their stance on enforcement of fair lending laws,[38] participants in the lending market should remember that there are nevertheless private

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33 After the Synapse collapse, the FDIC proposed a new rule related to bank recordkeeping of these types of deposits, which are sometimes considered brokered deposits. The rule has not moved forward as of this writing.

34 The Dodd-Frank Act also required a state attorney general or regulator to file a notice with the CFPB if they intended to bring an action for CFPA violations. This was one of the agency rules that the CFPB rescinded, but later the agency indicated that it would reinstate the requirement of notice from state litigants.

35 Exec. Order No. 14281, "Restoring Equality of Opportunity and Meritocracy," 90 Fed. Reg. 17537 (Apr. 23, 2025).

36 OCC Bulletin 2025-16, Fair Lending: Removing References to Disparate Impact (July 14, 2025).

37 FIL 41-2025.

38 At the time of publication, the Federal Reserve has not publicly reversed its stance on enforcing the disparate impact theory or indicated if it will follow the Executive Order.

rights of action under those fair lending laws that have been upheld in court. Accordingly, litigation on this theory is likely to continue and could increase.

### *2. Preemption—Challenges to National Bank Rules*

The scope of preemption is a perennial issue and is discussed in later sections of this publication. Most recently, the Supreme Court issued a ruling in 2024 that preemption challenges need to be decided under the standard articulated in the Dodd-Frank Act.[39] As to national banks, state laws are preempted if they discriminate against national banks or the law prevents or significantly interferes with the exercise of the bank's federally granted powers.[40]

After the *Cantero* decision, the Conference of State Bank Supervisors requested that the OCC rescind its preemption regulations. In June 2025, the OCC responded by denying the request and strenuously affirmed the importance of federal preemption as "a cornerstone of the dual banking system." The Acting Director of the OCC defended the regulations as allowing national banks to operate across state lines, remove barriers, achieve efficiencies associated with a uniform set of rules, and foster the development of national products and services that benefit individuals and businesses in all states. The OCC further stated that its regulations are consistent with both the Dodd-Frank Act and the *Cantero* decision.

However, two recent decisions have found that state laws requiring the payment of interest on mortgage escrow accounts are not preempted, which is the same issue as was presented in the *Cantero* case.[41] Preemption may also have a more uncertain path given the Supreme Court's recent decision overruling the Chevron doctrine, which required courts to defer to the regulations and interpretations of a federal agency in the context of an ambiguous statute.[42] Accordingly, courts may now consider any and all factors and make their own determinations when there are challenges to an agency's rules or guidance. As a result, there may be more challenges to federal agency determinations or less adherence to them by courts.[43]

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39 *Cantero v. Bank of America, N.A.,* 602 U.S. 205 (2024) (Case No. 22-529). The case involved the payment of interest to mortgage loan borrowers that had set up escrow accounts with the national bank to pay taxes and insurance. New York has a law mandating the payment of interest on escrow accounts. The bank did not pay interest on those accounts. The Second Circuit found in favor of the bank and upon appeal, the high court reversed and remanded the case back to the circuit court.

40 The Dodd-Frank standard is found at 12 U.S.C. 25b(b)(1). The standard of review was articulated in *Barnett Bank of Marion Cty., N.A. v. Nelson*, 517 U.S. 25 (1996).

41 *Kivett et al. v. Flagstar Bank, FSB*, Case No. 21-15667 (9th Cir. Oct. 2, 2025); *Conti v. Citizens Bank*, No. 22-1770 (1st Cir.) (dismissal vacated finding that the state law regarding interest on escrow accounts is not preempted).

42 *Loper Bright Ent. v. Raimondo*, 603 U.S. 369 (2024) overruling *Chevron U.S.A. Inc. v. Nat. Res. Def. Counsel, Inc.*, 467 U.S. 837 (1984).

43 Such challenges could subject national banks to adherence to state laws such as disclosures that the OCC has previously found to be preempted.

A logical question is often raised concerning whether state laws regarding usury are subject to challenge under these same theories. Although the OCC has adopted regulations concerning preemption of state usury laws, these regulations are established pursuant to a separate statute, Section 85 of the National Bank Act,[44] and longstanding precedent that a national bank may charge interest at the rate permitted by the state where the bank is located.

#### *3. BNPL and Housing*

In June 2025, the Department of Housing and Urban Development (*"HUD"*) issued a Request for Information concerning BNPL products.[45] HUD is trying to determine the impact of BNPL on housing affordability and stability and, in particular, upon the ability of mortgage borrowers to meet and handle housing expenses for residential loan programs insured by the Federal Housing Administration. Typically, HUD does not consider closed-end unsecured loans, including BNPL products, as part of its underwriting guidelines. Given the growth of BNPL and possible reliance on it as short-term funding, HUD is seeking comments on how BNPL affects the ability to pay mortgage loans, how to assess the repayment risk from this new product, and whether its underwriting guidelines should be revised to include BNPL. Comments were due by August 24, 2025.

## II. STATE ACTIONS AFFECTING MARKETPLACE LENDING

### A. State Laws on Usury and Predominant Economic Interest

Over the last few years, several states have enacted statutes aimed at marketplace lending participants that are service providers to Funding Banks. Those laws are described later and are focused primarily on parties holding the predominant economic interest in a loan and on theories of evading state licensing and usury laws. However, that trend seems to have lessened during the 2024–2025 legislative season.

Alaska's legislature passed such a statute, but it was vetoed by Governor Mike Dunleavy.[46] Like other similar legislation, this proposal would have added a predominant economic interest test to the statute, anti-evasion provisions, and a maximum usury rate of 36% that would apply to consumer loans up to $25,000. Also included in the proposed law was a territoriality provision providing that a transaction takes place in Alaska if the borrower is an Alaska resident and completes the transaction either in person or electronically while physically present in Alaska. Notably, covered loans made in excess of the 36% limit would be void and unenforceable. Due to Governor Dunleavy's veto, however, this legislation will not become effective.

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44 12 U.S.C. 85.

45 "Request for Information Regarding Buy Now Pay Later Unsecured Debt," 90 Fed. Reg. 26824 (June 24, 2025).

46 Alaska SB 39, amending the Small Loan Act, Alaska Stat. Ann. 06/20.010 *et seq*.

Also noteworthy is that both houses of the Virginia legislature passed Senate Bill 1252, which purported to cap interest rates on most loans as well as on earned wage access products at 12%. The legislation was not well drafted, although one of its primary purposes was to curb lending in the state from out-of-state lenders operating via the Internet. In March 2025, the Governor of Virginia vetoed the legislation and therefore it never went into effect.

### B. Regulation of BNPL Programs

Given the popularity of BNPL programs, legislation is now following innovation, and several states are therefore seeking to regulate BNPL providers, including through licensing, required disclosures, and other restrictions. Given that the CFPB is not prioritizing BNPL enforcement, states are acting to fill in the gap, creating a potential patchwork of laws with which BNPL providers will need to comply.

In May 2025, New York enacted legislation that imposes licensing requirements on BNPL service providers. It limits interest to 16% and prohibits the charging of any unfair, abusive, or excessive penalty or fee. It also mandates disclosure requirements, standards for the resolution of disputes, and privacy protections.

California BNPL providers must be licensed under the California Financing Law and the state considers the BNPL product to be a consumer loan.

Georgia requires BNPL providers to obtain an installment lender license to offer BNPL products up to $3,000. This applies whether or not interest is charged in connection with the product.

Maryland also requires licensure and compliance with the Consumer Loan Law for BNPL providers.

As of January 1, 2023, New Mexico enacted rules that require BNPL licensing, provided that the products are installment loans (less than $10,000) and subject to the small loan law, unless another exemption applies.

### C. Earned Wage Access (*"EWA"*)

#### *1. State Laws*

Another popular and innovative product is EWA. It provides a way for wage earners to access their earned funds prior to their next pay date. This can be accomplished through a program sponsored by the employer or by direct arrangements with the employee. Again, as these programs become more popular, they are catching the attention of state legislatures, which are enacting laws affecting EWA programs. These often include licensing, disclosures, sometimes limitations on fees, and usually the ability for the employee to be able to access the funds with a no-cost option. Since some programs rely on tips made by the consumer, legislation often prescribes that tips be voluntary and fully disclosed.

These laws will sometimes address a crucial question: whether or not the EWA product is a loan.[47] As with BNPL, the potentially different and conflicting state laws create a patchwork for compliance purposes. We summarize the key aspects of these state laws below.

***Arkansas.*** EWA legislation was signed into law in Arkansas on March 20, 2025, and became effective on August 4, 2025.[48] While EWA is considered to be a financial product, providers do not need to become licensed in connection with lending, money transmission, or debt collection. All fees must be disclosed prior to consummation and there must be at least one no-cost option to access funds which is clearly disclosed. Credit card repayment is prohibited, and interest and late fees are not allowed. If tips are an option, they must be disclosed as voluntary and must default to zero.

***Connecticut.*** In 2023, state regulators deemed EWA to be a small dollar loan and subject to usury limitations, effectively shutting down EWA in the state as of January 1, 2024. However, new, albeit somewhat restrictive, legislation was passed by the legislature and became effective October 1, 2025. EWA is still designated as a small loan and providers must be licensed, but there are different finance charge requirements for EWA. Providers cannot engage in debt collection and certain limits apply to advances. At least one no-cost option must be provided, and tips must be voluntary.

***Indiana.*** The law and implementing regulations become effective on January 1, 2026. EWA is not considered to be a loan, credit, or money transmission, and fees and tips are not finance charges. However, EWA providers must be licensed, are subject to quarterly reporting requirements, and must have surety bonds in place. Fees must be clearly disclosed and a no-cost option provided. Tips must be disclosed as voluntary. There are several restrictions on repayment, including no credit card payments, no late or deferral fees, no interest, and no reporting to credit bureaus.

***Kansas.*** The law was effective July 1, 2024. EWA products are not loans or money transmission, and are not subject to the Kansas Uniform Commercial Code. Fees and tips are not interest. Providers must be registered and submit annual reports. All fees must be disclosed.

***Louisiana.*** This state's law became effective August 1, 2025. EWA is not considered credit, money transmission, or debt collection. No licensing is required, but if the provider charges fees, annual reports must be submitted to the regulator. Fees must be disclosed and one no-cost option provided. Tips must be disclosed as voluntary. Credit repayment is not allowed nor is interest, late fees, or other penalties.

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47 Whether or not an EWA product is a loan has significant consequences. If it is a loan, the product may be subject to state licensing requirements. Depending on how the product is characterized, this could also bring into play money transmitter, credit service organization, or debt collection laws and licensing. Also, if it is a loan, usury would be implicated, although by nature these are often no interest products—but often rely on tips, fees or other compensation that could be considered interest. EWA providers argue that making funds available that a person has already earned but not been paid should not be considered a loan as they are merely being advanced funds on their next paycheck.

48 House Bill 1517, "Earned Wage Access Services Act," Act 347 (Mar. 20, 2025).

***Maryland.*** Enacted in May 2025, EWA legislation became effective on October 1, 2025. EWA is a loan and subject to Maryland lending laws. EWA is not money transmission. Licensing is required and there are annual reporting requirements. Fees are limited to $5 for advances up to $75, and $7.50 for advances greater than $75. A no-cost option must be offered. Clearly disclosed voluntary tips are calculated as interest and cannot exceed 2.75% per month or an annual rate of 33% on loans of $500 or less. Late fees, interest, or other charges for nonpayment are not allowed. Reporting to credit reporting agencies is prohibited and providers are not allowed to use a credit report as a condition for providing EWA services.

***Missouri.*** Missouri was an early adopter of an EWA law, which was effective August 28, 2023. EWA is not a loan or money transmission and, as a result, providers are not lenders or money transmitters. Charges are not considered interest, but interest cannot be charged on unpaid balances. Registration with the regulator is required. Unlike other states, a no-cost option is not required and repayment by credit card is allowed.

***Nevada.*** The first state to have an EWA law was Nevada, where EWA is not considered a loan, credit, or money transmission and fees and tips are not finance charges. Registration is required with the banking regulator and annual reporting is mandated. There is a surety bond requirement. Clear disclosure of fees, a no-cost option, and disclosure of voluntary tips are all a part of the law. There are no restrictions on repayment with credit cards, but no fees or interest can be charged for late payments or on unpaid balances.

***South Carolina.*** South Carolina's EWA law went into effect on November 21, 2024. Earned wage advances are not a loan or money transmission, and fees/tips are not finance charges. Registration is required. There is a surety bond requirement. All fees must be clearly disclosed and there must be an easily accessible no-fee option. Consumers must be told that tips may be zero. Credit card repayment is not allowed. Deductions from payroll must receive separate consent. No fees may be charged for late or missed payments.

***Utah.*** Utah's EWA law became effective on May 7, 2025. EWA is not a loan or money transmission, and fees or tips are not finance charges. Providers may not collect unpaid advances. There is a registration requirement. There are specific disclosure requirements. There must be a no-cost option, and tips must be noted as voluntary. There can be no charges or interest for late or no payment, and credit cards cannot be used for repayment.

***Wisconsin.*** The state was an early adopter of EWA legislation, which was effective September 1, 2024. Products are not loans, but providers must register annually and submit annual reports. There is a surety bond required. Like most states, in Wisconsin all fees must be clearly disclosed, and a no-cost option must be detailed. Tips must be voluntary, and a zero option must exist. Credit card repayment is prohibited, and fees or interest cannot be charged for late or missed payments.

***California.*** Although California does not have a specific law regarding EWA, registration is required with the Department of Financial Protection and Innovation (*"DFPI"*). Reporting is required. Advances are considered loans that must comply with disclosure requirements and usury limitations.

***Montana, Arizona, Georgia, and Vermont.*** In December 2023, the Attorney General of Montana issued an opinion that EWA products are not loans and do not require licensure. The EWA products must meet certain requirements for this exemption, but if they do, any fees or voluntary tips are not interest. Similarly, the Arizona Attorney General issued an opinion in December 2022, as did the Georgia Attorney General in December 2024, and the Vermont Department of Financial Regulation issued a no-action letter in April 2024.

### *2. Litigation Concerning EWA*

EWA has also generated some litigation. The Attorney General of New York has filed an action against an EWA provider, alleging claims related to taking illegal wage assignments, violation of usury laws, false advertising, fraud, and deceptive acts and practices.[49] The EWA provider attempted to move the case to federal court, which was denied in September 2025. Accordingly, the case will proceed in state court.

Similarly, the Attorney General in the District of Columbia filed an action against an EWA provider, claiming deceptive marketing practices, making high cost loans without a license, and charging undisclosed fees.[50] In Pennsylvania, a court dismissed claims that an EWA product violated the unfair trade practices and consumer protection law.[51] There, the court found that the EWA product was not subject to the state's lending laws or usury limits, and fees charged were not finance charges under the federal Truth in Lending Act. However, that court reversed this interpretation after a deeper review and found that there only needs to be a connection between the fee and the extension of credit to be a finance charge.[52]

In October 2025, a federal court found that a monthly subscription fee to use a mobile application and an instant payment fee to receive a cash advance on the wages earned faster than the normal process were both finance charges, making the EWA provider a creditor under the federal Truth in Lending Act.[53]

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49 *State of New York v. DailyPay, Inc.*, Case No. 154851 (N.Y. Sup. Ct. filed Apr. 14, 2025).

50 *Dist. of Columbia v. ActiveHours*, Case No. 2024-CAB-007303 (D.C. Super. Ct. filed Nov. 19, 2024).

51 *Golubiewski v. Activehours, Inc.,* Case No. 3:22-cv-02078, 2024 WL 4204272 (M.D. Pa. 2024).

52 *Id.*, 2025 WL 2484192 at 6 (M.D. Pa. Aug. 28, 2025).

53 *Vickery et al. v. Empower Finance, Inc.*, No. 25-cv-03675-JSC (N.D. Cal. Oct. 7, 2025). At issue was a motion to compel arbitration and stay class action litigation related to the EWA product. The plaintiff was in the military and claimed the fees were finance charges that violated the Military Lending Act and the arbitration agreement was unenforceable. The court denied the motion.

A growing number of case decisions are finding that fees charged for expedited receipt of cash advances in EWA products constitute finance charges.[54]

EWA providers claim that cash advances to earned wages are not credit. Further, the Commentary to the federal Truth in Lending Act indicates that an alternative to obtain funds without cost invalidates an early transfer fee from being a transfer fee. In the above case, however, the court found the fee for faster access to be incidental to the extension of credit. Even where a no-cost alternative is available, courts are concluding that finance charges may be found where it is difficult for the consumer to obtain the promised credit without paying the fee for expedited receipt.

These decisions provide an interesting contrast to the state laws described above that find EWA to be non-credit products and exempt from state lending laws.[55]

We can expect more litigation in the coming days as to EWA products, and in particular their characterization as loans or not.

### D. Colorado Opt-Out Legislation Challenge

As discussed in more detail elsewhere in this publication, the Colorado legislature enacted a law purporting to opt out of federal preemption for state banks. The law was challenged in court and, in June 2024, the federal district court issued a preliminary injunction that kept the law from going into effect.

Federal law allows state banks to export to all other states the rates and fees of the state where the bank is located, but when the law was enacted, it also gave states the right to opt out of this preemption. Initially, six states opted out, but most opted back in, such that only Iowa and Puerto Rico were opted out prior to Colorado's action. The federal law does not apply to national banks, federal savings associations, or credit unions and is discussed elsewhere in this treatise.

What an opt-out means, and what the consequences of an opt-out are, remain undetermined; hence the Colorado litigation. The state contends that the opt-out means that the law of the state where the borrower resides determines where a loan is made for purposes of the opt-out. The countervailing viewpoint is that where a loan is made is based upon the non-ministerial functions of making a loan:

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54 *See, e.g., Moss v. Cleo AI Inc.*, No. C25-879-MLP, 2025 WL 2592265 (W.D. Wash. Sept. 8, 2025) (finding an express fee was intertwined with the obtaining of a cash advance); *Johnson v. Activehours, Inc.*, No. 1:24-cv-02283-JRR, 2025 WL 2299425 (D. Md. Aug. 9, 2025) (expedited fee necessary to get advertised purpose of fast cash); *Orubo v. Activehours, Inc.*, 780 F. Supp. 3d 927 (N.D. Cal. 2025) (fee for fast receipt was necessary to obtain credit on terms offered).

55 Cash advance programs appear to be under scrutiny. In November 2024, the Federal Trade Commission filed a complaint against Dave, Inc., a fintech cash advance provider. *Fed. Trade Comm'n v. Dave, Inc.*, Case No. 2:24-cv-9566 (C.D. Cal. Nov. 5, 2024). The FTC referred the case to the Department of Justice, who filed an amended complaint in this suit against Dave, Inc. and its chief executive officer. The allegations deal with misleading marketing tactics and charging undisclosed fees without customer consent. The action seeks a permanent injunction and imposition of civil penalties and customer refunds.

where the credit decision occurs, from where the credit decision is communicated, and from where the loan proceeds are disbursed, which typically would be where the lender—not the borrower—is located. The Colorado federal district court sided with the latter position. The case was appealed to the Tenth Circuit Court of Appeals.

Several amicus briefs were filed in the action, including by banking trade groups and several Republican attorneys general, in support of the industry position. The FDIC filed an amicus brief supporting Colorado's position, although the FDIC took a contrary position previously. However, after the change of federal administrations, the FDIC withdrew its amicus brief in February 2025. Oral arguments to the Tenth Circuit were held in March 2025.

On November 10, 2025, the Tenth Circuit Court of Appeals issued a lengthy opinion with one of the three justices dissenting. The majority reversed the decision of the district court and remanded the case back to the district court. The opinion found that loans made in the opt-out state included loans made to borrowers residing in that state but where the lender was not located in Colorado. The dissent noted that, under the ruling, a loan could be deemed to have been made in multiple states, creating uncertainty as to what rate applied to the loan. This decision may affect marketplace programs operating in Colorado and could encourage other states to legislate opt-outs to federal preemption of marketplace loans.

### E. Nevada Eliminates In-State Office Requirement for Internet Lenders

On May 28, 2025, Nevada Governor Joe Lombardo signed Senate Bill 437 (*"SB 437"),* which makes key changes for qualifying "Internet consumer lenders" under the Nevada Installment Loan and Finance Act (Title 55, Chapter 675) (the *"Act"*).

The Act requires all entities engaging in "the business of lending" in Nevada to obtain the Installment Loan Company License. The business of lending definitionally includes the solicitation of loans in Nevada. The Act's anti-evasion provision further provides that the licensing requirement applies to any person who seeks to evade the law's requirements. Thus, the Act effectively imposes a licensing requirement on all fintechs that market, solicit, or broker consumer loans through their online lending platforms on behalf of bank-sponsored programs.

Historically, Nevada has been somewhat problematic for fintech and bank partnership lending programs, as the Act previously required an in-state office for any entities seeking a license under the Act. In 2019, however, Nevada enacted legislation exempting "Internet business lenders" (*i.e.,* online lenders making commercial-purpose loans) from its in-state office requirement.

Some consumer-facing fintech companies have chosen to ignore the Nevada law, others have accommodated the in-state office requirement, and some have avoided the state entirely. SB 437 eliminates the in-state office requirement for "Internet consumer lenders." Effective October 1, 2025,

fintechs that qualify as Internet consumer lenders may obtain the Installment Loan Company License without the burden of establishing and maintaining an office in Nevada.[56]

### F. Securitization Licensing Scare in Maryland

In 2024, a Maryland court issued an opinion dealing with licensing related to mortgage loans.[57] The Office of Financial Regulation issued a directive on January 1, 2025, interpreting that case to require the licensing of passive trusts holding Maryland residential mortgage loans in mortgage-backed securitization transactions.[58] Licensing was to be made by April 10, 2025, but was extended until June 2025 pending possible legislative action.

On April 22, 2025, Maryland's governor signed emergency legislation that was passed to correct this problem.[59] The legislation became effective immediately. As a result, passive securitization trusts as defined by the law[60] that hold Maryland mortgage loans do not have to be licensed in Maryland.[61]

### G. Georgia Merchant Acquirer Limited-Purpose Bank Charter

Although the statute has been part of the Georgia Code for some time, there has been recent interest in a limited-purpose bank charter for merchant acquiring.[62] The statute allows a payment processing company to be its own acquiring bank with direct access to the card networks without the need of having an intermediary bank involved in the process. This allows the acquirer to authorize and settle

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56 SB 437 establishes specific requirements for contracts between Internet consumer lenders and Nevada residents, aiming to ensure transparency and fairness in lending practices. Specifically, it requires that the loan agreement use Nevada as the governing law of the contract unless an exemption applies. However, SB 437 exempts loans made by federally and state-chartered banks through a carve-out for loans preempting state law under federal preemption. Bank loans should be exempt from this requirement.

57 *Estate of Brown v. Ward*, 251 Md. App. 385 (2024).

58 This directive sent shudders through the securitization world, since passive securitization vehicles typically do not get licenses to engage in holding loans for financing purposes. Securitization activity involving Maryland loans paused, or such loans were kicked out of securitization transactions. The securitization industry began efforts to legislatively change this position.

59 "Maryland Secondary Market Stability Act of 2025," passed pursuant to HB 1516 and its companion bill SB 1026.

60 The legislation defines a "passive trust" as a trust that (1) acquires or is assigned mortgage loans in whole or in part; (2) does not make mortgage loans; (3) is not a mortgage broker or a mortgage servicer; and (4) is not engaged in the servicing of mortgage loans, which does not include the act of transmitting or directing payments received by a mortgage servicer. The legislation defines "trust" as "any trust established under the laws of the State or any other state." Hence, the "passive trust" must be an actual trust and not a non-trust corporate entity.

61 This type of situation raises the issue generally of whether or not securitization vehicles need to be licensed under various state laws. Such an analysis is beyond the scope and purpose of this publication but is an area that is gaining more attention as the amount of marketplace assets grow. Many securitizations use a trust with a national bank trustee to hold the securitized assets under the theory that a national bank is generally exempt from licensing requirements. But another type of entity may require licensing in some states.

62 Georgia Code 80-12-1 *et seq*.

payment transactions more efficiently. Beginning in 2024, large payment processors obtained this charter, and other applications have been filed. This is a limited-purpose charter and applies only to payments. Taking of deposits or the making of loans is not permissible under this charter.

### H. Hawaii

In Hawaii, the installment loan law covers loans to $1,500. Previously, licensing was required for any person or entity arranging a loan for a third party. Hawaii Senate Bill 1367 was enacted and became effective on July 1, 2025. This legislation amended the definition of an installment lender to eliminate the requirement for licensing for one who arranges an installment loan for a third party if that party is not required to be licensed as an installment lender under Hawaii's law. Banks are exempt from licensing under the Hawaii Installment Loan Law. Thus, third-party service providers to banks are now exempt from licensing under this law. Previously, many marketplace lending programs only offered loans above $1,500 due to the licensing requirement. Bank programs with a service provider marketing the loans should now be able to make loans of any amount to Hawaiian residents without licensing. Licensing is still required for third parties acting for persons required to be licensed under the law.

### I. Ohio Small Loan Act License

In December 2024, the Ohio Division of Financial Institutions (*"Division"*) issued "Updated Guidance on Bank-Fintech Partnerships" (the *"Guidance"*). The issuance provided that non-banks that broker bank loans of $5,000 or less must obtain a Small Loan Act license. In addition to requiring a license for lending, it also required a license from any entity that receives interest greater than that allowed by the law (25%) or arranges a loan for a fee or any manner of compensation. The Guidance stated that the licensing requirement would apply whether compensation is derived from the consumer or from the bank. The Guidance also indicated that a license is required for arranging a loan even if no compensation is received (although this goes beyond the wording of the licensing statute). Under the Guidance, fintechs soliciting loans for banks would need to be licensed as well as fintechs who purchase loans with rates and fees in excess of 25%. The Guidance is noteworthy since the penalty for violation of the Small Loan Act is voiding of the loan, and receipt of interest greater than allowed results in a penalty of twice the amount of interest contracted for. There are also possible criminal penalties.

Industry efforts led to some clarifications. For instance, the state will allow licensees to arrange loans for a bank and receive interest on loans made by a bank that exceed the 25% interest and fee limitations of the Small Loan Act so long as the entity does not charge or receive additional amounts over and above the contracted-for rate of interest.

Further guidance was issued on October 31, 2025. In an about-face (or Halloween treat), the Division indicated that it will not require any non-bank entity to become licensed under the Small Loan Act for arranging bank loans even if it is compensated. Therefore, fintechs arranging loans for banks for loans under $5,000 do not have to be licensed by the Division to engage in this action. The Division indicated that it will not pursue enforcement actions against non-banks that did not apply for or obtain a license

in 2025. The Division also stated that any entity that makes or arranges loans of $5,000 or less but does not charge interest does not have to be licensed under the Small Loan Act. This would apply to Buy Now Pay Later providers. Again, the Division will not pursue enforcement there either. There is also a provision of the Ohio Code that prohibits a licensee from making a loan of $1,000 or less or that has a duration of one year or less. The October guidance of the Division states that it will not enforce or apply this law against any activity that is not subject to licensure as discussed above.

The updated guidance provides needed clarity for Ohio lending activity. There is currently no requirement to obtain a license to arrange bank loans over $5,000 in Ohio.

## III. LITIGATION UPDATES

***True Lender.*** For marketplace lending participants, the issue of true lender remains important. Although discussed at length later in this publication, programs where fintechs act as service providers to banks have been subject to litigation. The theory is that where an online fintech platform markets a loan on behalf of a bank that funds and makes the loan, but the fintech then services that loan and often buys the loan or participates in a large portion of the economics of the loan, the fintech—rather than the originating bank—is the true lender for that loan. As a result, state usury limitations, rather than the bank's exportable interest rate under principles of federal preemption, are alleged to apply to the loan. Interestingly, there have been few developments in this area over the last year and no significant substantive decisions.

One reason that some cases are never decided is litigation strategy. Most online lending loan agreements contain an arbitration provision requiring the parties to arbitrate any dispute, which results in individual arbitration actions rather than class actions. Plaintiff counsel will often file a complaint alleging true lender theories and requesting class certification in state court. Most often, defendants will remove the case to federal court on either a diversity of citizenship basis or a federal question being presented as to preemption of state usury laws. Defendants will then move to compel arbitration. Courts are generally favorable to granting motions to compel arbitration.[63]

One case that is being watched is in California. Although described later, the California regulator (the DFPI) was about to bring an action based on true lender theories against a high-rate program managed by Opportunity Financial, Inc., but with the loans made by a Utah state bank. Opportunity Financial sued offensively, asking for a declaratory judgment that the bank was the true lender on the loan.[64] Later the DFPI sought an injunction against the program to suspend the making of further loans in the state,

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63 This is exactly what happened in a case with an online lending program where the plaintiffs alleged violation of state usury laws and other state consumer protection statutes. The court dismissed the action and sent the parties to individual arbitration. *Dieffenbach et al. v. Upgrade, Inc.*, Case No. 4:23-cv-0427-MWB (M.D. Pa. Dec. Apr. 29, 2025). Other cases with similar results are discussed later.

64 *Opportunity Fin., Inc. v. Hewlitt*, Case No. 22-ST-CV-08163 (Sup. Ct. Los Angeles Cty.).

which was denied. The case has been in discovery and a trial is scheduled for early in 2026. However, on September 26, 2025, Opportunity Financial filed a motion for summary judgment on the basis that the Utah bank is the lawful lender and is exempt from California's usury limitations. California claims that, in actuality, the fintech is evading the state's interest rate limit through a sham lending arrangement with the Utah bank. The consequences of this decision are monumental in that an adverse decision could affect all fintech-bank programs in the largest consumer lending market in the country.

*Tenth Anniversary of Madden Decision.* In May 2015, the Second Circuit decision in the Madden case (discussed elsewhere at length) rocked the marketplace lending industry.[65] The decision held that the rate a bank charged on a charged-off loan sold to a debt buyer cannot be charged by the purchaser of the loan where the bank no longer has any interest in the loan. This overruled the longstanding doctrine of "valid when made," which holds that a loan valid when made remains valid when sold or transferred to an assignee of that loan. Although the decision by the Second Circuit was almost universally considered to be incorrect, the U.S. Supreme Court declined to hear an appeal of the case. Five years later, both the OCC and the FDIC issued regulations that codified the valid when made rule, and these regulations were upheld upon a court challenge. No further appellate decisions followed the Madden rule, so to the extent it is precedential, it is so only in the states that comprise the Second Circuit: New York, Connecticut, and Vermont. Until Madden is challenged in the Second Circuit, the effect of this decision has been diminished, if not eliminated, elsewhere.

*Interchange-Regulation II.* Regulation II of the Federal Reserve was promulgated in 2011 and is known as the Durbin Amendment. Regulation II caps debit interchange fees that banks may charge, but exempts small issuers with assets less than $10 billion.[66] Two recent challenges to Regulation II resulted in different decisions. A North Dakota federal court found the debit card interchange rule to be invalid and vacated the rule but stayed the effectiveness pending appeal.[67] Days later, a Kentucky federal court found Regulation II to be validly enacted, contrary to the North Dakota decision.[68] States are also looking at the interchange issue. For example, the Illinois legislature passed a statute that interchange may not be charged on taxes and tips. This law is being challenged in federal court, and other states are considering similar legislation.

## IV. CHARTER UPDATE

Given the deregulation focus of the current administration, an issue arises as to whether fintechs will seek to apply for full banking powers as industrial banks under either state law or federal law. The

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65 *Madden v. Midland Funding, Inc.*, 786 F.3d 246 (2d Cir. 2015).

66 Interchange refers to fees charged by card-issuing banks and is typically paid by merchants for the privilege of accepting payment cards for payment for the purchase of goods and services.

67 *Corner Post, Inc. v. Bd. of Governors of the Fed. Reserve Sys.*, 499 S. Sup. 3d 808 (D.N.D. 2025).

68 *Linney's Pizza, LLC v. Bd. of Governors of the Fed. Reserve Sys.,* Case No. 3:22-cv-00071-GFVT (D. Ky).

different charter alternatives are discussed in the following sections of this book. Industrial banks have the benefit of their owners not being subject to the restrictive provisions of the Bank Holding Company Act. Some fintechs may be attracted by the independence that a separate charter would provide and by the ability to preempt state law in many cases and avoid anti-evasion statutes. Conversely, a bank charter would subject a fintech to Community Reinvestment regulations, capital requirements, and adherence to business plans that would require regulator approval to change, potentially impairing the ability to be nimble and innovative. Some recent developments on bank charters for fintechs are discussed below. In particular, some fintechs are seeking a limited purpose trust charter related to digital assets and cryptocurrency custody and transactions.

### A. FDIC Withdraws Proposed Rule on Parent Companies of Industrial Banks

In August 2024, the FDIC proposed a rule regarding parent companies of industrial banks. That rule would have made relationships between an industrial bank and its parent more restrictive and problematic, as well as a point of scrutiny in the FDIC application process. For example, commitments in written agreements with the parent would not necessarily have resolved statutory factors of concern in reviewing an application for deposit insurance. The proposed rule expressed concern over business models reliant on parent company sources of business. In July 2025, however, the FDIC withdrew the proposed rule and issued a request for information on how the FDIC should review applications submitted to establish industrial banks. Thus, the industrial bank application process will be less restrictive and limited to the FDIC's prior 2021 rules on such applications. The request for information seems to be focused on concerns about retailers being parent companies of those institutions. The sense is that the FDIC wants to approve industrial bank applications.

### B. OCC Grants Charter to Fintechs

In March 2025, the OCC conditionally approved the application of Billfloat, Inc. d/b/a SmartBiz Loans to acquire Centrust Bank, N.A. in Northbrook, Illinois. SmartBiz acted as an online small business lending platform primarily for Small Business Administration Loans. Although high capital requirements (11% tier 1 leverage ratio) were imposed, the approval signaled that the OCC was "open for business" for new charter applications.

In October 2025, the OCC granted a conditional approval for a full purpose national bank to Erebor which will engage in deposit taking, lending, and digital asset transactions. In particular, the bank is targeting technology companies utilizing virtual currencies. The OCC is permitting the bank to hold virtual currencies on its balance sheet to pay transaction fees as being a power related to banking. The interesting aspect of this approval was that it occurred within four months after the application was filed, potentially signifying a new approach to granting charters under the Trump regime.

Applications are pending at the federal banking agencies for auto loan companies and fintechs as well as companies desiring limited-purpose charters primarily related to digital assets.

A number of companies have applied for limited purpose trust company charters from the OCC. These include cryptocurrency fintechs Circle, Ripple, BitGo, Protego Holdings, Wise, and Paxos. In addition, Coinbase, Stripe, and Sony have applied for limited purpose charters. Conventional banking trade groups have submitted concerns to the OCC that the contemplated activities of the applicants are not fiduciary in nature and go beyond the intended purpose of a limited purpose trust charter.

## V. 2025 DIGITAL ASSETS UPDATE

The current administration has made significant strides this year by moving digital assets into the mainstream, drawing a sharp contrast against the previous administration's position that effectively debanked and regulated through enforcement against the crypto industry. Digital assets cover a wide range of technologies and encompass more than cryptocurrencies, and broadly refer to any digital representation of value that is recorded on a distributed ledger.[69] The digital assets ecosystem is vast and evolving, offering a wide range of current and future-use cases.

### A. Digital Assets Relevance to Marketplace Lending

#### *1. Blockchain for Clearance and Settlement*

Marketplace loans can be "tokenized" using smart contracts, and the rights of such tokens can be transferred and settled on the blockchain. This type of token can be referred to as a "real world asset," or RWA, and is expected to receive the same legal and regulatory treatment as if it were not in tokenized form. In other words, a token that represents a single loan or its servicing rights may not be treated as a security, but a pool of such loans or rights may be, if considered a security even without tokenization.[70] The tokenization process is attracting attention for its ability to facilitate the development of an active secondary trading market for marketplace loans.[71]

#### *2. DeFi*

In a DeFi protocol, a developer establishes a series of smart contracts and decentralized applications (*"DApps"*) that create an ecosystem for defined activities that exist wholly or largely within the blockchain network. These systems are generally intended to be available to any party with access to the blockchain network, although some require the acquisition of a particular token or, more rarely, the

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69 Executive Order No. 14178, note 1 at §2(a).

70 See SEC Comm'r Hester Peirce, Enchanting, but Not Magical: A Statement on the Tokenization of Securities (July 9, 2025) ("As powerful as blockchain technology is, it does not have magical abilities to transform the nature of the underlying asset. Tokenized securities are still securities. Accordingly, market participants must consider—and adhere to—the federal securities laws when transacting in these instruments.").

71 It would be necessary to consider whether any tokens representing financial interests in marketplace loans constitute "securities" subject to regulation under federal and state securities laws. Any such tokens offered to retail investors would likely be treated as securities (which in turn would likely make the offering impractical because of securities law registration requirements).

white-listing of access. These DeFi systems include projects that seek to remove intermediaries from digital asset trading platforms (decentralized exchanges, or *"DEXs"*), to provide investment exposure to baskets of digital assets (baskets or set tokens), and to generate yield based on over-collateralized loans (DeFi lending, or *"yield farming"*). A general premise often advanced for DeFi projects is that, following publication of the smart contracts and DApps, the developers of the project cede control to the network users, meaning that no administrator, issuer, or sponsor controls the system and has operational or regulatory responsibility for its activity. The accuracy and practicality of this premise are largely untested, both on a factual and legal basis. This presents a significant issue for both retail users and potential market entrants seeking to assess DeFi opportunities.

> **Keep in Mind:** The open access of most popular blockchain networks presents an issue for any party seeking to access a public blockchain for even the simplest of purposes. In most blockchain activity, standard transactions are bilateral in nature, simplifying the "know your counterparty" equation and risks. With DeFi, a prospective participant cannot easily ascertain the identity of the counterparties that also access the DeFi application. As government agencies, including the Office of Foreign Asset Control, have begun to focus more on digital asset networks, financial institutions and all other users exploring DeFi must consider anti-money laundering, countering the financing of terrorism, and sanctions compliance risks.

#### *3. Digital Assets as Collateral*

It may be years before firm guidance exists regarding the use of digital assets in lending, or confirmation that blockchain and smart contract technology can be used to adequately describe assets intended as collateral for purposes of the UCC. Even more complex issues are raised by the emergence of DeFi protocols that seek to entirely remove intermediaries and sponsors that fill regulated roles in commercial activity. It follows that, for the foreseeable future, certain aspects of blockchain systems will likely remain subject to some (or a great) degree of legal uncertainty. Among the more salient issues are those regarding applicability of state statutes governing property law and title. Given the differences in state adoption of various sections of the Uniform Commercial Code, lenders could be left with uncertainty around such questions as whether they have clear ownership rights when they receive a stablecoin. Without a uniform body of law regarding free and clear ownership by a stablecoin holder, the rights to collateral could be disputed.

### B. Stablecoins

One rapidly accelerating use case in digital assets includes transacting in payment stablecoins. A stablecoin, generally, is a digital asset that retains a relatively consistent value based on (i) the right of users to create and redeem the digital asset for an underlying asset (which may be a single asset or basket of assets) or (ii) an algorithmic or smart contract-based system that incentivizes the stabilization of assets through supply control and collateralization.

Stablecoins may become significant to the marketplace lending sector in some or all of the following ways: (i) loan issuance and servicing in payment stablecoins, (ii) taking stablecoins as collateral and how to treat them during underwriting and ability-to-pay analyses, (iii) where lenders should custody stablecoins and the financial institutions' holding omnibus vs. segregated accounts for lenders or borrowers, and (iv) the potential need to compete with stablecoin lending offered via decentralized finance. Marketplace lenders that choose to issue loans or take repayment in payment stablecoins will either need to establish custody and safekeeping of those assets or contract with a service provider (offering "stablecoins as a service") that will handle such custody arrangements and maintain either omnibus or segregated accounts to assist with loan servicing. Payment stablecoins, as defined under the GENIUS Act (defined below), likely may be valued at $1.00 for purposes of underwriting and tax reporting given their full 1:1 backing by U.S.-denominated reserve assets. But how should other stablecoins be valued? Can they be considered high-quality liquid assets for underwriting purposes? Rules forthcoming from the Treasury Department will determine the answer to those and many other questions.

### C. Federal Stablecoin Legislation

Enactment of the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act (the *"GENIUS Act"*) was a pivotal moment for stablecoins and a significant legislative development for the U.S. digital assets industry.[72] The GENIUS Act creates a comprehensive dual-track regulatory framework for licensing and supervision of payment stablecoin issuers at either the federal or state level. The GENIUS Act defines a "payment stablecoin" as a digital asset (*i.e.,* any digital representation of value which is recorded on a cryptographically secured distributed ledger) that is, or is designed to be, used as a means of payment or settlement, and the issuer of which represents that such digital asset will maintain stable value and is obligated to convert, redeem, or repurchase for a fixed monetary value by its issuer.[73] The definition expressly excludes bank deposits (including deposits recorded using distributed ledger technology), securities, and national currencies.[74] Payment stablecoin issuers are not permitted to pay interest or yield solely for holding, use, or retention of payment stablecoins.[75]

Prior to enactment of the GENIUS Act, the SEC Division of Corporate Finance had issued a Statement on Stablecoins on April 4, 2025 (the *"SEC Statement"*), clarifying that tokens designed to maintain a stable value relative to, and to be redeemed for, the U.S. Dollar on a one-to-one basis, backed by low-risk, readily liquid assets in reserve are not considered securities, which is a definition that is broader

72 GENIUS Act, Public Law 119–27, 139 Stat. 419 (2025).

73 GENIUS Act, § 2(22); see *id.* §§ 2(7)–(8).

74 GENIUS Act, § 2(22)(B)(i)-(iii) (2025).

75 GENIUS Act, § 4(a)(11) (2025).

than the subsequent GENIUS Act definition of "payment stablecoin."[76] Because the SEC Statement preceded the GENIUS Act definition and the SEC has remained silent on this issue since, there remains the possibility that federal securities laws may apply to any other type of stablecoins other than a "payment stablecoin."[77]

### D. Overview of the GENIUS Act

The GENIUS Act requires issuers of payment stablecoins to maintain reserves backing the issuer's payment stablecoins outstanding on at least a 1:1 basis by USD-denominated reserves such as cash or U.S. Treasuries. These reserves may not be pledged, rehypothecated, or reused by the issuer, except in limited circumstances. Generally, the reserves, the payment stablecoins, and cash of each of the issuer and a customer cannot be commingled and must be kept in segregated accounts by a state or federally regulated institution. Issuers are required to publish monthly reports that include the total number of outstanding payment stablecoins issued and the amount and composition of reserves, along with the issuer's redemption policy. Such reports must be certified by the issuer's CEO and CFO and examined by a registered public accounting firm following publication. Issuers will be required to comply with regulations on capital requirements, liquidity standards, reserve requirements, and compliance and operational standards to be issued by their respective federal or state regulator.

Issuers are considered financial institutions subject to the Bank Secrecy Act with responsibilities to comply with U.S. sanctions, anti-money laundering, customer identification, due diligence, and other related laws. Holders of payment stablecoins will have a priority claim to segregated reserve assets that is senior to the claim of any other creditor of the reserve custodian.

Permitted stablecoin issuers may be (i) insured depository institutions, generally including banks and credit unions, acting through a subsidiary as approved by their federal functional regulator; (ii) non-banks, uninsured national banks, and branches of foreign banks who receive approval from the OCC; or (iii) non-banks that apply to their state regulator and plan to issue less than $10 billion in aggregate stablecoins. Potential stablecoin issuers will be able to submit applications to the relevant state or federal regulator starting one year after passage of the GENIUS Act (approximately July 2026).

The GENIUS Act also opens the opportunity for state financial services regulators to oversee issuances of stablecoins by the entities they regulate. The statute provides a state regulatory option for non-bank issuers with less than $10 billion in outstanding stablecoins—provided that the state regulatory regime is "substantially similar" to its federal counterpart as determined by the Treasury Department. State regulators would "have supervisory, examination, and enforcement authority over all" state issuers. The

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76 SEC Statement on Stablecoins (Apr. 4, 2025).

77 *Id.* See footnote 72; "yield-bearing stablecoins" are stablecoins providing holders with yield, interest, or other passive income, whether in the form of regular payments or rewards, or in the form of "re-basing," which is a mechanism that automatically adjusts the total supply of the stablecoins.

GENIUS Act allows state regulators to cede these authorities to the Federal Reserve. The GENIUS Act also allows the Federal Reserve or the OCC to take enforcement actions against state issuers in "unusual and exigent circumstances."

The Biden administration era saw a bit of a pullback on the federal banking regulators' positions, which have since shifted back to a more technology-neutral and open-minded position as of this writing. The OCC currently has five operative interpretive letters on crypto-related matters[78] and has rescinded one.[79] While the OCC, the Federal Reserve Board, and the FDIC required notice and pre-approval of any crypto asset-related activities through 2024, each later retracted that guidance,[80] did away with any "reputational risk" rankings,[81] and trended toward permitting the institutions that they respectively supervise to include bank crypto asset companies as well as entities that engage in such crypto asset-related activities as "facilitating the customer's cryptocurrency and fiat currency exchange transactions, transaction settlement, trade execution, [recordkeeping], valuation, tax services, reporting, or other appropriate services," among others.[82]

Since the GENIUS Act became law, the prudential financial regulators (the OCC, the Federal Reserve, and the FDIC) issued their Joint Statement on Crypto-Asset Safekeeping by Banking Organizations on July 14, 2025, addressing crypto asset safekeeping services such as safekeeping as a fiduciary or non-fiduciary service provider. Banks should assess the risks of providing crypto asset safekeeping services, including implementing a risk governance framework appropriate to the evolving nature of crypto assets and addressing asset volatility.

### E. Progress Toward Federal Market Structure Legislation

Beyond payment stablecoins, another subject attracting Congressional attention is the structure of digital asset markets. The House passed the Digital Asset Market Clarity Act of 2025 (the *"CLARITY Act"*) on July 17, 2025, in an attempt to provide a clear and comprehensive classification for all digital assets, introducing digital commodities and digital asset securities. On the Senate side, a competing draft bill, the Responsible Financial Innovation Act of 2025, is also progressing, with additional drafts and

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78 OCC Interpretive Letter No. 1170 (July 22, 2020) (custody of crypto assets); OCC Interpretive Letter No. 1172 (Sept. 21, 2020) (deposit reserves); OCC Interpretive Letter No. 1174 (Jan. 4, 2021); OCC Interpretive Letter No. 1183, OCC Letter Addressing Certain Crypto-Asset Activities (Mar. 7, 2025); OCC Interpretive Letter No. 1184 (May 7, 2025).

79 OCC Interpretive Letter No. 1179 (Nov. 18, 2021).

80 OCC Interpretive Letter No. 1183, OCC Letter Addressing Certain Crypto-Asset Activities (Mar. 7, 2025); FDIC, Financial Institutions Letter FLI 7-2025 (Mar. 28, 2025); Federal Reserve Board announces the withdrawal of guidance for banks related to their crypto asset and dollar token activities and related changes to its expectations for these activities (Apr. 24, 2025).

81 Office of the Comptroller of the Currency, OCC Ceases Examinations for Reputation Risk (Mar. 20, 2025); Board of Governors of the Fed. Reserve Sys., Federal Reserve Board announces that reputational risk will no longer be a component of examination programs in its supervision of banks (June 23, 2025).

82 Office of the Comptroller of the Currency, OCC Clarifies Bank Authority to Engage in Crypto-Asset Custody and Execution Services (May 7, 2025).

comments forthcoming. Any resulting Senate bill will need to be reconciled with the CLARITY Act before passage.

One of the questions at issue in passing a federal market structure bill is whether and to what extent it would preempt state money transmitter laws for covered securities, commodities, or ancillary assets. In addition to the money transmitter licensing regime described in, and potentially preempted by, the federal regulatory frameworks described below, the following states require specialized licenses to operate a virtual currency business or offer such products to their residents:

- ***New York.*** New York was the first state to adopt comprehensive regulation of digital financial assets. The New York Department of Financial Services (*"NYDFS"*) requires crypto businesses to obtain a BitLicense, which entails robust compliance obligations such as Know Your Customer (KYC) procedures, capital requirements, and ongoing reporting.[83] The complexity and expense of obtaining a BitLicense have led to criticism that it hampers innovation.

    - On September 17, 2025, NYDFS issued guidance to all New York Banking Organizations (the *"2025 Guidance"*) recommending that they consider leveraging blockchain analytics tools to enhance their compliance programs and risk frameworks if they are engaged in, or are contemplating engaging in, virtual currency-related activity (*"VCRA"*).[84] The 2025 Guidance significantly expands to apply NYDFS blockchain analytics expectations from 2022 to all New York Banking Organizations,[85] not just BitLicense holders and limited-purpose trust companies (collectively, *"VCEs"*). This reflects the regulator's recognition of banks' increasing involvement in and exposure to VCRA, and it emphasizes its position that blockchain analytics are a useful risk-identification and risk-mitigation tool, given the public, immutable, and pseudonymous nature of blockchain transactions.

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83 23 NYCRR Part 200.

84 VCRA includes all "virtual currency business activity," as that term is defined in 23 NYCRR § 200.2(q), as well as the direct or indirect offering or performance of any other product, service, or activity involving virtual currency that may raise safety and soundness concerns for the bank or that may expose New York customers of the bank or other users of the product or service to risk of harm. For example, NYDFS considers the following types of activities, among others, to be virtual currency-related activities: offering digital wallet services to customers, whether the services are in fact provided by the bank or by a third party with which the bank has contracted; lending activities collateralized by virtual currency assets; activities in which a bank facilitates its own customers' participation in virtual currency exchange or trading, including by carrying fiat currency on behalf of customers (*e.g.*, in an omnibus account); services related to stablecoins, including providing stablecoin reserve services for stablecoin issuers; or engaging in traditional banking activities involving virtual currency through the use of new technology that exposes the bank to different types of risk (*e.g.*, underwriting a loan, debt product, or equity offering effected partially or entirely on a public blockchain). Industry Letter Regarding Prior Approval for Covered Institutions' Virtual Currency-Related Activity, N.Y. State Dep't of Fin. Servs. (Dec. 15, 2022).

85 Banking Organization means "all banks, trust companies, private bankers, savings banks, safe deposit companies, savings and loan associations, credit unions and investment companies." N.Y. Banking Law § 2(11).

  - On September 30, 2025, NYDFS issued updated guidance to replace its 2023 Guidance on Custodial Structures for Customer Protection in the Event of Insolvency, providing further guidance for VCEs regarding the structuring of their asset custody framework to protect customers, addressing segregation and separate accounting for customer virtual currency, limiting a custodian's possession of or interest in and use of customer virtual currency, guidelines on sub-custody arrangements, and customer disclosure.[86]

- ***California***. Starting July 1, 2026, California's Digital Financial Assets Law will require crypto companies to be licensed by the Department of Financial Protection and Innovation.[87] The law sets forth stringent requirements for digital asset businesses, including stablecoin issuers, and imposes significant penalties for non-compliance.

- ***Louisiana***. After June 30, 2023, a license under the Virtual Currency Business Act is required to engage in virtual currency activity in Louisiana.[88]

- ***Illinois***. On August 18, 2025, Illinois enacted the Digital Assets and Consumer Protection Act, establishing a regulatory framework designed to enhance customer protections for digital asset activities, requiring covered businesses to register with the Department of Financial and Professional Regulation, and enforcing consumer protections similar to those for traditional financial services, such as disclosure obligations, custody requirements, and customer service standards.[89]

- ***Wyoming***. While states like New York and California come to mind as vanguard state regulators, Wyoming also has been a leader in digital asset regulation. Over the last few years, Wyoming was the first state to allow decentralized autonomous organizations (*"DAOs"*) (*i.e.,* decentralized members making decisions for the blockchain "on-chain" through code and smart contracts) to obtain company status, then established a distinct legal framework for DAOs to operate legitimately as a recognized legal entity. Wyoming was the first state to pass a law allowing the state to create its own stablecoin in 2023 and announced in August 2025 its plans to launch its own stablecoin—the Frontier Stable Token (FRNT) as legal tender for debts owed to the state government.

Other than the few states that have passed standalone laws governing digital assets and virtual currency activities, most states regulate virtual currency activities through their money transmission laws. Kansas

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86 N.Y. DFS Letter Updated Guidance on Custodial Structures for Customer Protection in the Event of Insolvency (Sept. 30, 2025).

87 Cal. AB-1934, Digital financial asset business (Ch. 945); https://dfpi.ca.gov/regulated-industries/digital-financial-assets/.

88 Cal. AB 1934, Digital financial asset business (Ch. 945); La. Virtual Currency Business Act.

89 SB 1797, 104th Gen. Assembly (2025) (enacted as Pub. Act 104-0428).

and Texas have indicated in guidance that certain activities involving stablecoins are subject to money transmission laws, but activities involving other virtual currencies (*e.g.,* Bitcoin) may not be.[90]

90 CML Guidance MT 2014-01 Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmission Act-Purpose (Jan. 2, 2025); Texas Department of Banking – Supervisory Memorandum 1037 (Jan. 28, 2025).

# Regulatory Issues

## I. REGULATORY MATTERS

Given either the true lender challenges facing marketplace lenders that work with Funding Banks or the licensing and compliance burden of being a multistate-licensed lender, it is no surprise that marketplace lending participants and service providers are looking at the possibility of obtaining banking type charters as a business model. Options include starting or purchasing a bank, the OCC special purpose national bank charter, or an industrial bank state charter. The "full-service" bank charters would encompass compliance with all regulatory requirements that come with a full-purpose bank charter. Regulatory hurdles have limited this business model coming to fruition. These options and their history as related to marketplace lending are discussed below.

### A. Charters for Marketplace Lenders

#### *1. OCC Proposed Special Purpose Charter for Fintech Firms*

On December 2, 2016, the OCC announced that it was considering issuing special purpose bank charters to qualified fintech companies.[91] In its press release, the OCC took the position that applying a bank regulatory framework to fintech companies would (i) benefit customers, businesses, and communities and will help ensure that these companies operate in a safe and sound manner; (ii) result in the OCC's uniform supervision of fintech companies, promoting consistency in the application of laws and ensuring that consumers are treated fairly; and (iii) make the federal banking system stronger by including these companies. Many within the industry viewed the OCC's announcement as a victory for fintech companies that have argued for a national charter so they can establish a uniform national program and avoid obtaining various state licenses and facing different laws and restrictions in each state or the complexities of working with an unaffiliated Funding Bank.

In conjunction with this announcement, the OCC issued a white paper titled "Exploring Special Purpose National Bank Charters for Fintech Companies," detailing many issues that must be resolved by the OCC before it will grant a special purpose bank charter to a fintech company. The white paper was not a proposed rule requesting a response to substantive proposals by the OCC; rather, it was a request for information from the industry and the public. This was another step in the direction of identifying the requirements that would be applied by the OCC to a fintech company seeking a national bank charter, and it points out agency concerns but not how these concerns would be resolved.

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91 This development came almost simultaneously with the OCC promulgating a final rule addressing the receivership of banks not insured by the FDIC, which would presumably apply to fintech companies that obtain a national bank charter but are not insured by the FDIC. In September 2016, the OCC also revised the "Charters" booklet of its Licensing Manual, which describes the process of applying for and obtaining a national bank charter, presumably with revisions contemplating the limited-purpose aspects of a charter applicable to fintech companies. Almost immediately, some state regulators both questioned and opposed the ability of the OCC to grant a limited-purpose charter.

The white paper solicited perspectives on several questions concerning the benefits and risks associated with approving fintech companies for a national bank charter and specific areas such as capital and liquidity requirements, commitments to financial inclusion and protecting small businesses in light of both safety and soundness considerations, and a proper regulatory scheme for technological companies.

> **Key Consideration:** We note that in the past the OCC has not said that there will be a "FinTech charter." Rather, the OCC will consider granting a special purpose national bank charter to fintech companies engaging in non-deposit-taking banking activities: lending or payments.[92]

The obvious benefits of a national bank charter include preemption of state usury laws, exemption from state licensing requirements, operationally being able to maintain a uniform national program, and autonomy and control by the marketplace lender, a feature not present in a Funding Bank arrangement as the regulated institution needs to control the loan program.[93] Since all national banks are members of the Federal Reserve System, there is also access to the Fed's payment system. Conversely, obtaining a national bank charter is complex, costly, and often subject to regulatory conditions. The chartering process usually takes at least several months and often a year or more. Public comment and field investigations are part of the process. Charter applicants must submit a three-year business plan and cannot deviate from it without OCC approval. This may inhibit the nimbleness that fintech companies utilize as a competitive advantage. Often the OCC will require a minimum level of capital and the ratio of capital to total assets must always be 8% or greater.

It is not known how the OCC might impose financial inclusion requirements on marketplace lenders seeking a charter, whether retention of some portion of loans will be required, or how off-balance sheet items such as loan sales will be treated for capital purposes. Federal law also limits transactions with affiliated companies and, absent a change in law and depending on how the interplay of regulators comes out, a parent company might become a bank holding company, subject not only to additional regulation but also to a restriction on being engaged in activities other than those constituting banking or being closely related to banking.[94]

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92 Whether and when the OCC might issue the first such charter is unknown and perhaps even speculative. No applications have been made to date, in part due to litigation as to the status of such charter and the prospect of litigation that would potentially confront an applicant.

93 One possible alternative is an industrial bank or industrial loan charter. Such a charter is discussed below and provides many of the same benefits as would an OCC charter.

94 If, however, the special purpose national bank is not required to accept deposits (and not be FDIC insured), it may not meet the definition of a bank under the Bank Holding Company Act and the parent would not be a bank holding company. The FDIC has imposed requirements on parents of such entities, including foreign parents.

It remains to be seen whether a special purpose bank charter will come into being, let alone be an appealing alternative for fintech companies, and what conditions the OCC may impose on granting such a charter.[95] All but the largest marketplace lenders may find certain of the requirements, such as the capital and compliance risk management requirements, sufficiently burdensome to outweigh the benefits of obtaining a national bank charter. It is also a long-term business strategy, not one that can be deployed in a short time frame. The availability of a national bank charter to qualified marketplace lenders could also have an impact on the competitive balance of the industry if investors come to view chartered lenders as "safer" or "more sound" than those that do not obtain charters and the latter companies, as a result, are put at a competitive disadvantage in raising lending capital.

***Fintech Charter Proposal Brings Lawsuits.*** The OCC's announcement that it would explore the possibility of a special purpose charter led to two lawsuits being filed against the agency. In May 2017, the New York Department of Financial Services (*"NYDFS"*) brought an action claiming that granting such special purpose charters would exceed the authority of the OCC.[96] The OCC sought to dismiss the suit on the grounds that the NYDFS's claim was not "ripe" because the OCC had not yet made a final determination about whether to grant such charters. On December 12, 2017, the court granted the OCC's motion to dismiss. The Conference of State Bank Supervisors (*"CSBS"*) had filed a similar action in April 2017, arguing that the OCC did not have the authority to grant a limited-purpose bank charter to a non-bank entity.[97] The OCC also sought to dismiss this action as premature since the OCC had not taken any formal action with respect to such a charter. The motion to dismiss was granted by the court on April 30, 2018.

When the OCC announced that it would accept applications for this charter, both the CSBS and NYDFS again filed suit against the OCC. While the CSBS action was dismissed, the NYDFS action ruled against the OCC, finding that being a bank required the acceptance of deposits. On appeal, the Second Circuit Court of Appeals dismissed the suit for lack of standing without deciding the issue of whether a national bank charter required the taking of deposits.

The New York regulator's suit against the OCC claimed that granting a special purpose charter to entities that would not take deposits went beyond the OCC's statutory authority, which is limited to institutions engaged in the business of banking.[98] The OCC filed a motion to dismiss the action, which was denied by the district court, which ruled that national banks must accept deposits. The OCC appealed and in June 2021 the Second Circuit reversed the lower court and directed the lower court to

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95 One fintech, Varo Bank, N.A., obtained a full-service national bank charter, and another fintech, Social Finance, Inc., was approved to acquire and now operates a national bank, SoFi Bank, N.A. Other fintechs have been rumored to be interested in a full-purpose national bank charter. LendingClub Corporation acquired a bank holding company and its subsidiary bank headquartered in Massachusetts, and now operates as LendingClub Bank, N.A.

96 *Vullo v. Office of the Comptroller of the Currency,* 17 Civ. 3574 (S.D.N.Y. filed May 17, 2017).

97 *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency,* Civ. Act. No. 17-CV-0763 (D.D.C.).

98 *Lacewell v. Office of the Comptroller of the Currency*, Case No. 1:18-cv-08377 (S.D.N.Y.), Case No. 19-4271 (2d Cir.).

dismiss the action. The appellate court found that the claims were not ripe for decision and the regulator failed to allege the required element of suffering an injury. Thus, the basic question of whether the business of banking requires the taking of deposits is left to another day or likely to be litigated if there is an application for a special purpose charter.

> While there have been no takers on the OCC "fintech" charter, some marketplace lenders have obtained full-service national bank charters.

The OCC is no stranger to litigation. In December 2020, the Conference of State Bank Supervisors filed an action challenging the OCC's approval of a special purpose charter application to a non-bank based on the New York district court decision discussed above.[99] The plaintiffs desired that the court rule that the OCC could not grant charters to entities without their taking deposits and obtaining FDIC insurance. In January 2022, the Conference withdrew its complaint after the bank charter applicant changed its application to seek FDIC deposit insurance, which would moot the claims made in the complaint.

Given the litigation surrounding nondepository charters, fintechs attempting to obtain a bank charter have opted to buy existing banks or apply for a full-service charter that would include the taking of deposits rather than apply for the special purpose charter.[100]

### *2. Federal Deposit Insurance Corporation*

***Industrial Bank Charters.*** Attention has been given to the possibility that fintech companies could apply for industrial bank charters (also called industrial loan companies, or ILCs) under state law.[101] There are some 25 ILCs in existence, most of them chartered under Utah law.

Industrial loan companies must also apply for FDIC insurance. While they can take savings or time deposits, the implementing laws do not allow them to take demand deposits. The allure of an ILC is that it can provide most types of financial products and services except for demand deposit accounts, obtain the benefits of federal preemption from state usury laws as an FDIC-insured institution, and they may be owned by non-bank companies. ILCs, even though insured by the FDIC, are exempt from the definition of "bank" under the federal Bank Holding Company Act, and therefore an ILC may be owned by a commercial company without becoming subject to that law's extensive regulations and supervision

99 *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, Case No. 1:20-cv-03797-DLF (D.D.C.). The case dealt with the application of Figure Technologies.

100 LendingClub Corporation purchased Radius Bancorp and its subsidiary bank on February 1, 2021. On July 30, 2020, the OCC also approved the application of Varo Bank, N.A., which became the first fintech to receive a full-service charter. In January 2022 the OCC approved conditionally an application from Social Finance, Inc., to purchase Golden Pacific Bank, N.A., and rename it SoFi Bank, N.A., which is also a full-service national bank.

101 Utah, California and Nevada are the only states that currently have industrial banks, with the majority in Utah. Although other states have statutory frameworks that allow for industrial bank charters, they are not currently active according to the National Association of Industrial Banks (*"NAIB"*): http://industrialbankers.org/.

of bank holding companies by the Federal Reserve.[102] Utah requires an ILC and its management to have an in-state presence and the FDIC requires a level of capital commensurate with the ILC's assets and the risks posed by its business plan. ILCs are subject to regulation and examination by their state chartering authority and the FDIC.

Until recently, the last company that had received an ILC charter did so in 2009, in part because of a federal moratorium on granting deposit insurance. The FDIC indicated a willingness to consider new deposit insurance applications, a development which could pave the way for marketplace lenders and other fintech companies to apply for an ILC charter with FDIC insurance. In June 2017, Social Finance, Inc. (*"SoFi"*), applied for an industrial loan company charter in Utah but later withdrew its application due to issues and changes in the top management of the company.[103] In addition, payment processor Square, Inc., filed an application to become a Utah ILC to offer small business loans and Nelnet also applied for FDIC insurance to provide additional financial products. The FDIC approved both applications in March 2020. Thus, the industrial bank charter became a viable alternative for fintech companies. However, after the change in federal administrations following the 2020 elections and change in leadership at the federal banking agencies, including the FDIC, pending applications have either stalled or been withdrawn, making the ILC charter's future for fintechs and marketplace lenders uncertain.[104]

> **Worth Noting:** A marketplace lender chartered as an ILC could undertake a uniform national lending program since, as an FDIC-insured state bank, it would qualify for federal preemption of state interest rate caps and exemption from most state licensing requirements. As a trade-off, the marketplace lender should be subject to direct and potentially greater supervision by the state regulator that grants its charter and by the FDIC. The ILC charter could become a preferred way for marketplace participants to offer Internet-based products and services.[105] But the stumbling block is obtaining approval from the FDIC for deposit insurance.

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102 The Bank Holding Company Act requires that a bank holding company limit its commercial activities to banking and activities that are closely related to banking. The act also limits the nature and amount of transactions of the holding company with its bank affiliates, imposes capital requirements and subjects the holding company to regulation and examination by the Federal Reserve. Since an ILC is not a bank, these limitations do not apply. Many ILCs are owned by commercial companies as a means of conducting their financial activities. When Walmart attempted to acquire an ILC, however, it resulted in a moratorium on the granting of ILC charters.

103 Clozel, Lalita, "SoFi Withdraws Bank Application in Wake of Scandal," American Banker, Oct. 13, 2017. Later, Social Finance, Inc. purchased a national bank.

104 In June 2024, an application for FDIC insurance was approved for a Utah ILC, Thrivent Bank. However, that bank is operating under a traditional business model and is not fintech oriented. Some members of Congress have also urged the FDIC to act on applications for insurance from Utah ILCs.

105 Marketplace lenders holding an industrial bank charter would be making their own loans under that authority rather than through a Funding Bank, so the risks and uncertainty of true lender challenges would likely be avoided.

Originally styled for industrial loan companies or ILCs, this charter has been around since the early 1900s.[106] As stated above, these institutions make loans and can accept savings and time deposits but cannot accept demand deposits, such as checking accounts. They are insured by the Federal Deposit Insurance Corporation (*"FDIC"*), which provides the benefit of federal preemption of usury laws and exemption from state lending licensing laws in most states.[107] Also of importance, they are not banks for purposes of federal law and therefore their owners are not deemed to be bank holding companies that are subject to various restrictions and prohibitions.[108] This means that non-bank companies including commercial entities may own industrial banks without being subject to regulation by the Federal Reserve. Unlike bank holding companies that are restricted to conducting business activities closely related to banking, owners of industrial banks are not so constrained. As a result, ILCs have been a source of continuing interest and controversy.[109]

> The industrial bank charter may be a feasible alternative if FDIC insurance can be obtained. The FDIC approved deposit insurance for an industrial bank, but recent applications have languished or been withdrawn.

As stated above, in 2020 two fintechs applied for and were subsequently approved by the FDIC for deposit insurance.[110] The FDIC previously indicated that the agency was open to *de novo* charter applications and the agency published new guidance on applying for deposit insurance, signaling a "green light" for receiving new applications, including those with different business models.[111]

106 Seven states have a regulatory regime that allows for industrial banks, but most industrial banks are chartered in Utah. There are about 25 in existence today.

107 Like a national bank, the institution would be making its own loans under principles of federal preemption rather than through a Funding Bank. The risks and uncertainty of true lender challenges would therefore be avoided.

108 See Bank Holding Company Act, 12 U.S.C. § 1842(c)(2)(H). In addition to being subject to Federal Reserve supervision and being permitted to engage only in financial activities and activities closely related to banking, bank holding companies are subject to a number of other rules, including restrictions on transactions with affiliates and capital requirements.

109 Utah placed a moratorium on new charters between 1986 and 1997 due to financial difficulties incurred by some institutions. Later, Walmart applied for a charter and the FDIC imposed a moratorium on approving FDIC insurance for industrial banks. In 2010, Congress also implemented a three-year moratorium on the granting of deposit insurance. All of this meant that new charters could not be issued for much of the recent past.

110 Social Finance, Square and Nelnet applied for ILC charters. All initially withdrew their applications. Square, along with Varo (discussed above) and Nelnet, refiled its application. Community groups filed letters in opposition to the applications, in particular as to compliance with the Community Reinvestment Act. The key concern seems to be how to apply that law to an online lender. As stated above, the FDIC has approved the insurance applications of Square and Nelnet. Social Finance has since acquired a national bank and Varo received an OCC national bank charter. In June 2024, General Motors withdrew its application for FDIC insurance for a Utah-based ILC.

111 *See* FDIC FIL-83-2018, Handbook and Procedures Manual for Application for Deposit Insurance. The FDIC also published guidance for parent companies of ILCs, including those that are foreign based.

However, the agency has indicated that, with respect to fintech companies, the FDIC needs to be very careful about allowing non-traditional entities into the banking system.[112]

In late 2018, following the leads of the OCC and CFPB, the FDIC also set up an Office of Innovation but with the focus on banks and working to help those regulated institutions innovate and compete with other financial technology companies. The FDIC indicated that it will look at innovation through the use of the ILC charter, regulation of third-party vendor relationships and working with technology companies to obtain better services and efficiencies for banks.

In early 2021, the FDIC adopted a final rule dealing with non-financial companies acquiring an industrial loan company and will require the non-financial company to provide certain commitments to the financial entity primarily related to capital and liquidity and enter into written agreements with the FDIC. The rule became effective on April 1, 2021. Promulgation of the rule may have been prompted at least in part due to fintechs exploring the industrial loan charter, which the FDIC stated in the preamble to the final rule. The regulation applies to companies that are or become subsidiaries of companies not subject to supervision by the Federal Reserve. The non-supervised company must also comply with reporting and record-keeping requirements. The company may not hold more than 50% of the board of directors of the financial institution and must agree to maintain capital and liquidity at FDIC-prescribed levels. The FDIC may also require the development of a contingency plan to address financial or operational stress. However, the industrial loan charter remains controversial and legislation has been introduced in Congress that would ban this charter.[113] The conventional view is that the Trump administration may make the ILC charter viable again.

### B. Other Regulatory Promulgations

For several years, the federal banking regulators did not make many public comments about marketplace lending. Perhaps this was because banks play a variety of roles in this space and the regulators primarily are in the business of regulating what banks do. Banks can be competitors to online lenders and potential purchasers of them. Banks are lenders to platforms and are also investors in marketplace loans. Banks can serve as trustees in securitization transactions of marketplace loans and have entered into "white label" programs where bank customers are referred to marketplace lenders for loans. Some banks are offering bank loans directly through an online platform as an alternative to partnering with a marketplace lender. Bank regulators have supervised and examined banks that serve as Funding Banks for online lending programs for some time, but largely without any public

112 The Independent Community Bankers of America, a trade association representing community banks, is lobbying against the ILC charter. It distributed a policy paper calling for a moratorium on providing deposit insurance to industrial loan companies as they are not subject to Federal Reserve supervision. The group may also oppose applications filed for deposit insurance by an ILC.

113 H.R. 5912 – Close the ILC Loophole Act was introduced in 2021 but failed to come to a vote.

comment.[114] This has changed with bank regulators bringing actions and entering into consent orders with Funding Banks based on marketplace lending programs in 2023 and 2024.[115]

However, this has changed dramatically as the marketplace lending industry and the involvement of banks in this space continue to expand and grow. In the last few years, banking regulators have made some significant pronouncements, both directly and indirectly, regarding marketplace lending, some of which are described below.[116]

> **Looking Ahead:** Regulatory promulgations and consent orders illustrate how marketplace lending programs have garnered the increasing attention of federal regulators. Regulation of marketplace lending is taking center stage with more acts to follow, which makes attention to compliance of critical importance for all market participants.

Federal consumer protection laws apply to all aspects of consumer credit from the origination of loans to the servicing of loans and attendant matters such as the protection of sensitive borrower data. Federal consumer protection laws are made by Congress and enforced by various regulatory agencies that may seek administrative penalties as well as civil, and in some cases criminal, liability resulting from violations of consumer protection laws. These laws and their corresponding regulations apply to online lending transactions. This section depicts recent federal regulatory supervisory and enforcement actions, highlights policy considerations being undertaken or discussed at the federal level and surveys recent Congressional initiatives affecting marketplace lending.

All of the federal agencies regulating banks and non-bank lenders have focused on financial technology companies and innovation. Each has an office dedicated to innovation and, over the last several years, the agencies have issued guidance that affects marketplace lending. Below are some of the more important pronouncements from federal regulators.

### *1. Office of the Comptroller of the Currency (OCC)*

***OCC Exam Procedures.*** On January 24, 2017, the OCC issued new Exam Procedures that supplement the OCC's Third Party Guidance. The Exam Procedures specifically reference bank relationships with

114 However, see the section below related to the FDIC for discussion of an enforcement action taken by the FDIC against a bank that funded loans (not marketplace loans) originated by a third-party service provider.

115 *See* "Recent Developments in Marketplace Lending Regulation," *infra*.

116 In response, the marketplace lending industry is forming groups to study and advocate regulatory issues. In April 2016, the Marketplace Lending Association was formed as a lobbying group. The Online Lending Policy Institute was also formed and conducted summits since 2016 related to policy matters in the industry. Both groups merged in March 2021 to form the American Fintech Council which is and remains an active voice for participants in the fintech space.

marketplace lenders, identifying certain aspects of these relationships that should be evaluated as part of a regulatory examination. These aspects include:

- Whether the bank has sufficient support systems, personnel and controls to adequately support the volume of planned loan origination, servicing or collections activities;
- Whether the marketplace lender uses underwriting methods that are new, nontraditional or different from the bank's underwriting standards;
- Whether the bank is subject to any recourse or participation arrangements as part of originating marketplace loans; and
- Whether the bank buys bonds, loans or notes from marketplace lenders and, if so, whether the bank has performed a robust credit risk analysis of that lender, determined that the loans meet the bank's underwriting standards, and determined whether the arrangement meets the OCC's regulatory investment and lending limits.

The Exam Procedures emphasize that a bank must maintain its own procedures and systems to ensure that the bank's core compliance and risk management responsibilities are not being outsourced to the marketplace lender.

*OCC Fintech White Paper.* On March 31, 2016, the OCC published a white paper on the fintech industry. While the paper is generally supportive of innovation and the improvements it brings, the OCC cautions that it must be accomplished in a safe and sound manner, consistent with principles of consumer protection. The OCC also announced that it had created a working group within the agency to monitor developments related to marketplace lending. On October 26, 2016, the OCC announced its decision to establish an Office of Innovation and to implement a regulatory framework supporting "responsible innovation." The Office of Innovation became operational in 2017. This is similar to the CFPB's original Project Catalyst and then its Office of Innovation (now Office of Competition and Innovation) to allow development of financial fintech in tandem with compliance with consumer protection laws.[117] This is indicative of the overall general interest of regulators in the space.[118]

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117 The CFPB announced changes that would promote innovation and expressed an appetite to allow a regulatory "sandbox" to allow market participants to experiment broadly, as has occurred in the UK.

118 We note that a group of Republican congressman indicated in the spring of 2016 that they would introduce an "innovation initiative." Led by Congressman Patrick McHenry, the "Financial Services Innovation Act of 2016" (H.R. 6118) was introduced in Congress in September 2016 and subsequently referred to committee. The legislation is an attempt to create a fintech regulatory sandbox in the United States, a concept that already exists in the UK and Hong Kong. Specifically, the bill mandates the creation of a Financial Services Innovation Office (*"FSIO"*) within each of the federal banking and financial services regulators. Individuals who want to offer an innovative financial product or service could petition the affected agency's FSIO for regulatory relief in the form of an enforceable compliance agreement modifying or waiving applicability of the regulation or statute implicated. A petition must propose an alternative compliance strategy and demonstrate that the innovative financial product or service: (i) would serve the public interest, (ii) improves access to financial products and services, (iii) would not present systemic risk to the U.S. financial system, and (iv) promotes consumer protection. While this legislation was not enacted, additional legislation may be considered by Congress in the future.

*OCC Fintech Charter.* As described elsewhere herein, the OCC has proposed a special-purpose "fintech" charter. This action was challenged by one lawsuit by the Conference of State Bank Supervisors which was dismissed in federal court in the District of Columbia. However, the New York Department of Financial Services also sued to block the issuance of this special-purpose charter in New York and, in May 2019, the federal district court denied the OCC's motion to dismiss the case, finding that a national bank requires the receiving of deposits in order to be a bank. The ruling is significant as the court stated that its decision would have nationwide effect so that the OCC could not issue any charter to any fintech company, not just one from New York. Upon the agreement of the parties, the court entered the decision as a final judgment in October 2019, thus allowing the OCC to appeal the ruling, which it did. The Second Circuit Court of Appeals subsequently dismissed the case without ruling on the deposit issue.[119]

The OCC filed a brief based on three tenets. First, the OCC maintains that New York lacks standing to bring the suit, as no one has yet applied for this charter and therefore any action is speculative. Second, the OCC states that its interpretation to allow a nondepository charter from a fintech company is both reasonable and entitled to deference. Third, the OCC asserts that any decision should not be entitled to nationwide application. New York filed its brief and the OCC filed a reply brief in August 2020. Given the litigation, there have been no applications for this charter during the pendency of that action or thereafter. The Second Circuit ultimately dismissed the action as not being ripe, hence the uncertainty; this charter's future, if any, remains in flux. The outcome of this case is also significant because the OCC has indicated that it would like to issue a special purpose payments charter to preempt state money transmitter laws and allow for a national payments and servicing platform.[120]

*OCC Seeking to Modernize Digital Activities Regulation.* On June 4, 2020, the OCC issued an advance notice of proposed rulemaking related to the digital activities of national banks and federal savings associations.[121] This promulgation seeks input on revising and modernizing the existing provisions of the Code of Federal Regulations related to electronic and technological aspects of banking. It is part of the OCC's push to foster the use of innovation and technology in banking. The public comment period was short, ending on August 3, 2020. The proposed rule was not finalized.

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119 *Lacewell v. Office of the Comptroller of the Currency,* Case No. 19-4271 (2d Cir. June 3, 2021).

120 The OCC may have other avenues to allow fintech companies to pursue a national charter. For example, in September 2020, the OCC approved the acquisition of an existing national bank based in Minnesota by a fintech company with plans to make the bank a digital bank. The Federal Reserve also approved the application of the parent, Jiko Group, Inc., to become a bank holding company. Rather than offering traditional demand deposit accounts, deposits will be invested in Treasury bills until the customer makes a withdrawal, whereupon the Treasuries will be converted into cash. In June 2024, based primarily on financial considerations, the Federal Reserve issued a Cease and Desist Order with respect to the parent holding company.

121 85 Fed. Reg. 40827 (July 7, 2020), to be codified at 12 C.F.R. pts. 7 and 155. On the same day, the OCC also issued a notice of proposed rulemaking related to bank operations which, although not directly related to financial technology, would help facilitate innovative technologies and digital activities.

The eleven questions posed by the OCC ask commenters to address new aspects of digital activities and whether regulation would be beneficial or burdensome to things such as digital finder activities, sale of software, cryptocurrency, distributive ledger technology, use of artificial intelligence and machine learning, payment technologies, regtech, other activities and changes due to the COVID-19 pandemic. However, the OCC stated that this initiative is not to comment on special purpose national banks related to fintech.

*OCC Proposes True Lender Regulation*. On July 22, 2020, the OCC issued a notice of proposed rulemaking related to who is the true lender on a loan.[122] In short, simple and succinct fashion, the OCC states that as of the date of loan origination the true lender is either the party named as lender on the loan agreement or the entity that funds the loan. The agency indicated that this rulemaking is being made in the context of bank partnerships with third parties, including marketplace lending. The OCC emphasized the piecemeal and divergent court decisions on the subject which are neither clear nor dispositive, have created uncertainty, discouraged third-party lending relationships, and limited competition. The OCC emphasized the need for predictable and stable markets that will allow for the continued availability of credit. If enacted, this bright-line test would provide a clear path to resolving the current existing ambiguities and confusing precedent.[123] The proposal was subject to a public comment period that ended September 3, 2020.[124] The OCC issued a final rule that was overturned by Congress under the provisions of the Congressional Review Act and, therefore, the regulation is of no force and effect. The FDIC did not propose a similar rule.

In October 2022, the Office of the Comptroller of the Currency released its bank supervision operating plan for the next year. It listed third-party relationships as one area called out for increased examiner scrutiny. In particular, the agency highlighted relationships with financial technology companies and new products and services. As a result, fintech relationships with OCC-supervised banks will receive heightened focus and increased regulatory oversight.[125] The Acting Comptroller has raised questions about the complex arrangements between banks and fintechs. The OCC said the focus will be on assessing whether there is proper oversight of these relationships commensurate with the risk posed.

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122 85 Fed. Reg. 44223 (July 22, 2020), to be codified as 12 C.F.R. pt. 7.1031.

123 The OCC correctly notes that divergent standards have emerged in true lender cases and that there is no predictable standard, as different factors are considered and not given the same weight, result in subjective determinations and undermine the certainty and stability needed in financial markets.

124 As would be expected, consumer advocates and groups tended to oppose the proposal while industry trade groups supported the proposal. Twenty-four state Attorneys General filed comments in opposition to the proposal.

125 A proposed interagency guidance on third-party relationships was enacted in June 2023 and generally proved to be consistent with prior OCC guidance on third-party relationships. The OCC has frequently asked questions on its website regarding third-party relationships and, in 2021, the OCC along with the FDIC and Federal Reserve released a guide on conducting due diligence on fintech companies. We note that third-party service providers to banks are subject to examination and regulation by the federal banking agencies under the provisions of the Bank Service Company Act, 12 U.S.C. § 1867(c).

The OCC said that it will assess whether both the bank and the fintech have sufficient and qualified personnel to meet contractual obligations.

On March 30, 2023, the Office of the Comptroller of the Currency announced the establishment of an Office of Financial Technology. Earlier, in October 2022, the OCC announced that it would be expanding upon its Office of Innovation, with this move designed to increase the agency's expertise and ability to adapt and respond to the pace of technological change in the banking industry. The regulator intends that this focus will provide for high quality supervision of bank-fintech relationships by expanding its knowledge of fintech platforms and applications to better achieve its goal of monitoring compliance by national banks and federal savings associations with applicable law and regulation. Like other regulators, the office will analyze, evaluate and discuss trends in financial technology, emerging and potential risks and implications for supervision. Emphasis will be placed on digital assets, fintech partnerships and emerging products and business models at or affecting OCC-chartered institutions.

The "Recent Developments in Marketplace Lending Regulation" section highlights that several digital asset companies are applying for a national trust charter from the OCC.

### *2. Federal Deposit Insurance Corporation*

***FDIC Draft Guidance Concerning Purchased Loans, Third-Party Lending Relationships.*** In November 2015, the Federal Deposit Insurance Corporation issued a Financial Institutions Letter (*"FIL"*) dealing with effective risk management practices for purchased loans and participations.[126] While this advisory is general in nature and applies to all forms of loan purchases and participations, the timing of its issuance suggested that one of the focal points was marketplace lending. The letter addressed the need for effective management of third-party risk when loans are purchased from non-bank entities or third-party arrangements. Financial institutions are encouraged to perform extensive due diligence and monitoring of third parties, especially in out-of-market loans. Banks should also assess the ability of third parties to meet obligations to the institution and review and should monitor compliance with laws and regulations such as consumer protection and anti-money laundering requirements. Although nothing in the guidance is either new or startling, its timing may affect marketplace programs with banks by encouraging banks to undertake a more extensive due diligence and monitoring process.

On February 1, 2016, the FDIC issued FIL 9-2016, announcing the publication of the Winter 2015 issue of "Supervisory Insights."[127] Part of this publication is devoted to the specific topic of bank relationships with marketplace lenders. It is clear that the FDIC understands that banks do participate in products and programs of this nature and that the FDIC understands the way the market operates, whether through a direct funding model or a bank partnership model. The FDIC considers such arrangements

126 FDIC FIL-49-2015 (Nov. 6, 2015).

127 The FDIC's Winter 2015 edition of Supervisory Insights can be found at the following link: https://www.fdic.gov/system/files/2024-06/siwin15.pdf/.

as third-party vendor relationships and expects banks, however they become involved in the industry, to follow third-party vendor management principles. This entails a determination that the bank's role is consistent with the overall strategy of the bank, assessment of the potential risks involved, and mitigation and management of those risks. It requires due diligence of the third party involved and appropriate contract protections for the bank. It also involves monitoring and oversight of the third party and correction of issues that are identified as problems or risks. The FDIC will evaluate the bank's role as part of its supervisory process.

Then, on July 29, 2016, the FDIC published FIL-50-2016, seeking comment on its proposed Guidance for Third-Party Lending applicable to FDIC-supervised institutions lending through a business relationship with a third party, including loan originator activities.[128] The guidance focuses on identification and assessment of risk commensurate with the third-party lending relationship. It would require due diligence, appropriate contract protections, ongoing monitoring, and remediation. Institutions with significant third-party lending relationships may be subject to increased supervisory attention and examination and review of the third parties.

These FDIC issuances offer a pragmatic approach to the current state of affairs. The FDIC treats a bank's involvement in marketplace lending like any other product or service the bank offers, consistent with its historical approach of not approving or disapproving of particular bank programs. Therefore, there is nothing inherently amiss when banks participate with non-bank companies. But before banks enter into such an arrangement, they need to identify, assess and mitigate risks; satisfy themselves that the third party (and the bank) is in compliance with applicable federal and state laws and regulations; and have a program for ongoing oversight and remediation. While some have assailed this pronouncement as yet another regulatory roadblock focusing the microscope on marketplace lending, in reality this practical approach of the FDIC seems positive in that it reaffirms the position that banks can play a role so long as it is performed prudently, and the FDIC is putting banks on notice of the rules they must follow to be a participant.

***FDIC Enforcement Action Against Funding Bank, Third-Party Service Provider.*** On March 28, 2018, the FDIC entered into two related settlements, one with a Funding Bank and the other with a third-party marketer/servicer of one of the Funding Bank's loan products, with facts analogous to many marketplace lending programs.[129] The loan product at issue was a debt consolidation loan where the service provider negotiated debt settlements on the borrower's behalf for a fee. The FDIC found that the Funding Bank and its third-party service provider had engaged in unfair and deceptive practices related to the marketing and origination of the loans and had violated the Electronic Funds Transfer Act

128 FDIC FIL-50-2016, "FDIC Seeking Comment on Proposed Guidance for Third-Party Lending" (July 29, 2016).

129 *In the Matter of Cross River Bank*, FDIC-17-0123b, FDIC-17-0121b and FDIC-17-0122k and *In the Matter of Freedom Fin. Asset Mgmt., LLC*, FDIC-17-0126b, FDIC-17-0125b and FDIC-17-0124k (both titled "Consent Order, Order for Restitution and Order to Pay Civil Money Penalty"), Mar. 28, 2018.

by requiring borrowers to pay by preauthorized ACH.[130] In addition, the FDIC determined that the loan disclosures violated the Truth in Lending Act because they failed to clearly and conspicuously state the terms of the loans by using estimates which were significantly different than the actual loan terms. The FDIC also found that the Funding Bank had failed to provide adequate oversight of its third-party service provider and did not have an adequate compliance management system to manage these relationships, including engaging in appropriate due diligence prior to entering into a relationship with a third-party service provider.

The FDIC exercised jurisdiction over the third-party service provider as an "institution-affiliated party" of the Funding Bank under the Federal Deposit Insurance Act.[131] Because the service provider was the primary actor in the program, the FDIC required restitution and required the service provider to deposit $20 million in a segregated account for consumer reimbursement purposes.[132] The service provider was also tagged with a civil money penalty close to $500,000.[133]

> **Key Point:** Marketplace lenders should remember that they too are subject to the jurisdiction of federal banking regulators when they partner with a Funding Bank and need to be vigilant in complying with the consumer protection laws applicable to their programs.

There are at least three important takeaways from this FDIC enforcement action for Funding Banks that have relationships with marketplace lenders: (1) federal regulators will hold the bank responsible for the products and services it originates, including those originated through a third-party relationship, and may impose civil money penalties for compliance deficiencies,[134] (2) banks are expected to have robust third-party risk management programs as required by federal regulatory guidance including appropriate risk assessment, initial and ongoing due diligence and oversight and correction of deficiencies, and (3) banks must maintain a strong compliance program to manage third-party risk

130 See the later discussion of EFTA and Regulation E under "Electronic Commerce Laws." Lenders cannot compel borrowers to pay loans by electronic means and whether authorizations for pre-authorized transfers meet this requirement or are valid has been the subject of litigation. In this case, the bank is being required to clearly and conspicuously explain that preauthorized electronic payments are optional and that a loan cannot be conditioned on the borrower repaying the loan in this manner.

131 12 U.S.C. §§ 1813(q) and 1813(u).

132 The FDIC orders require the service provider to pay all reimbursement amounts due to consumers, even if they exceed the deposited amount. In addition, the bank is responsible for restitution if the service provider fails to make payments to borrowers. Even if reimbursed, consumers retain any rights they may have against the bank and the service provider. Therefore, both the bank and the service provider could be subject to additional actions.

133 In November 2017, the CFPB filed suit against the service provider's affiliate debt relief company for the same actions. *See Consumer Fin. Prot. Bureau v. Freedom Debt Relief, LLC et al.*, Case No. 3:17-cv-064843 (N.D. Cal.). The CFPB settled this action in 2019 for a fine of $5 million and restitution of $20 million.

134 In this case, the FDIC imposed a penalty of $641,750 and stated that the bank is prohibited from being indemnified for that penalty.

including adequate policies, training, monitoring and audits of consumer protection laws as well as a consumer complaints process that timely identifies, reviews, investigates, responds to and resolves consumer complaints.[135] These principles are still valid and guide regulatory actions.

***Deposit Insurance.*** After a long drought of granting few approvals for applications for deposit insurance, the FDIC had been approving applications for deposit insurance, including to companies in the fintech space and to proposed industrial banks.[136] Recent applications have lingered, however. As discussed elsewhere in this book, the industrial bank is a viable option for marketplace platforms to obtain a banking charter. Recognizing this, the FDIC proposed a rule relating to the safety and soundness of industrial banks where the parent company is not subject to supervision by the Federal Reserve. The proposal would require a parent company to enter into written agreements with the FDIC and the industrial bank concerning the relationship of the parent company to the industrial bank, require capital and liquidity support from the parent to the industrial bank and establish appropriate recordkeeping and reporting requirements. The rule serves to codify existing supervisory processes and policies.[137]

***FDIC RFI Relating to Standards and Voluntary Certification.*** On July 20, 2020, the FDIC put out a Request for Information (*"RFI"*) as part of its efforts to promote new technology in banking.[138] The RFI poses 26 questions, asking for comments on the use of a standard setting organization (*"SSO"*) and voluntary certification of credit models and third-party service providers. The RFI is aimed at making it easier for smaller community banks the FDIC supervises to utilize modern technology in their banking operations. Smaller banks face high startup costs and barriers to entry that could be mitigated by use of models or service providers that meet certain standards or achieve certification. These standards and certifications would not replace existing guidance but instead would provide short cuts to vendor management and due diligence processes.[139]

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135 This strong action by the FDIC is in contrast to statements made by regulators from the Federal Reserve, OCC and CFPB at a banking conference in early 2018 that they would be more "flexible" in applying third-party risk management guidance to partnerships between banks and fintech firms. Interestingly, the FDIC did not make such a statement. The FDIC is the primary regulator of Funding Banks engaged in marketplace lending programs.

136 Approval was granted to Varo Bank, N.A., in February 2020. The OCC also approved the application to become a national bank and the bank officially opened in August 2020. In March 2020, the FDIC approved the deposit insurance application of Square, Inc. to create a de novo Utah-based industrial bank primarily serving merchants that process card transactions through Square. Also in March 2020, the FDIC granted a deposit insurance application of Nelnet, Inc. to create a Utah-based de novo industrial bank to originate and service student loans and other consumer loans. However, other fintech companies such as Robinhood and Rakuten have withdrawn their applications for deposit insurance. Other platforms desire to become a financial institution by purchasing an existing bank. In March 2020, LendingClub agreed to acquire Radius Bancorp, a $1.4 billion company based in Boston, Massachusetts.

137 The FDIC Statement indicates that industrial banks have operated for more than a century. In 1982 they became eligible for deposit insurance and parent companies were excluded from Federal Reserve regulation in 1987. Industrial banks are state chartered and supervised by the FDIC.

138 85 Fed. Reg. 44890 (July 24, 2020).

139 Chapman partner Marc Franson discussed the RFI with two senior officials at the FDIC. This discussion, sponsored by the Online Lending Policy Institute, is available on our website: www.chapman.com. Discussion with Brandon Milhorn, Chief of Staff to the FDIC Chairman, and Leonard Chanin, Deputy to the Chairman of the FDIC.

*FDIC Publications Promote Innovation.* The FDIC established FDiTech, its technology lab that partners with banks, private companies, regulators and others to bring about new technologies that enhance the operations of financial institutions and encourage innovation that meets consumer demand. In February 2020, the FDiTech issued its first publication, "Conducting Business With Banks—A Guide for Fintechs and Third Parties," to help fintechs partner with banks.[140] The FDIC also published guidelines to assist non-banks in understanding the de novo application process for nontraditional bank organizers. The FDIC in these documents indicated a commitment to work with any group interested in starting a financial institution and that given "sound business plans, experienced leadership … and appropriate capital support" they can "play a vital role in serving the deposit and credit needs of their communities." The FDIC has since eliminated the portion of this office's mission related to innovation and focuses only on internal FDIC technologies. This change was criticized by several Congressmen in a letter to the FDIC chair in 2023.

*Crypto and Deposit Insurance*. The FDIC has warned fintechs and banks about proper disclosure of deposit insurance, particularly when dealing with cryptocurrency arrangements. In July 2022, the FDIC and the Federal Reserve ordered a bankrupt cryptocurrency company to stop making false or misleading statements about deposit insurance.[141] In a cease-and-desist letter the agencies stated that customers were being misled that the company and their funds were protected by FDIC insurance or that customers would be insured if the company failed.

While some cryptocurrency arrangements have both a crypto and a cash component, only the cash component would be subject to insurability if held at an FDIC-insured institution. Those funds are insured only in the event of a failure of the financial institution, not the cryptocurrency company. Digital assets not held at a bank would not be subject to FDIC insurance coverage and in the event of a bankruptcy could be part of the bankruptcy estate and proceeding.

> Bank regulators are paying attention to bank relationships with crypto companies and statements made about deposit insurance.

On July 29, 2022, the FDIC issued FIL 35-2022 to all banks, advising them of the importance of clear and correct guidance on FDIC insurance where cryptocurrency companies and accounts are involved. The letter reiterates that FDIC insurance only covers deposits held in insured banks in the event of a bank failure and that the FDIC does not insure assets of non-bank entities such as crypto companies. It also

140 The Guide reaffirms portions of vendor and risk management guidelines of the FDIC and indicates that a financial institution will review a fintech's compliance, financial condition, management structure, risk management and controls.

141 The company involved was Voyager Digital. Like other cryptocurrency companies, it sought Chapter 11 bankruptcy protection when customers withdrew funds from its platform.

asks banks to confirm and monitor that those crypto companies are not misrepresenting the availability of deposit insurance.[142]

In March 2023 the FDIC addressed another cryptocurrency situation and demanded that the company cease making false or misleading representations about deposit insurance regarding protecting customers' cryptocurrency.[143] The company, not an insured depository institution, claimed that it was insured by the FDIC. It did not identify any insured institution with whom it had a relationship with respect to deposits and was a material omission.

***ILC Charter.*** In September 2022, a bipartisan group of U.S. Senators sent a letter to the acting FDIC Chairman expressing support for the industrial loan company (ILC) charter and stating that the FDIC needs to consider new deposit insurance applications from ILCs as well as other applicants under uniform federal standards. The senators extolled the virtues of the charter, including its historical success, providing additional expansion opportunities and performing niche lending in areas ignored by larger institutions. The letter concluded by asking that the FDIC not act disadvantageously toward ILCs.[144]

### *3. Department of the Treasury*

***Treasury White Paper.*** On May 10, 2016, the U.S. Department of the Treasury (the *"Department"*) published a white paper entitled "Opportunities and Challenges in Online Marketplace Lending" (the *"White Paper"*).[145] The White Paper states that marketplace lending can provide both consumer and small business borrowers with expanded access to credit but may also create risks that existing regulatory structures do not adequately address.

The White Paper follows the "Request for Information," or RFI, the Department published in July 2015 to solicit public input on various topics concerning marketplace lending. The Department received approximately 100 responses from marketplace lenders, trade associations, consumer and small business advocates, academics, investors, and financial institutions. Building on the RFI comments and its own market research, the Department makes a number of recommendations in the White Paper for regulatory and/or industry actions. The Department stated that its recommendations are intended to

142 The FDIC also issued a Fact Sheet for the public to clarify these points, primarily that deposit insurance does not cover non-deposit products including crypto assets. The FDIC continues to monitor these types of situations.

143 FDIC P.R. 24-23, 2023 WL 2645029 (Mar. 27, 2023).

144 Some charter applications have been pending at the FDIC for long periods of time or have been withdrawn. As discussed elsewhere, in 2022 the FDIC issued a rule concerning commitments to be obtained where the parent company is not a regulated financial institution. Since those companies are exempt from bank holding company regulations that restrict banking organizations, the ILC charter has been viewed as a way for non-banks to enter the financial field and has resulted in some degree of controversy about the ILC charter.

145 The White Paper is available at https://home.treasury.gov/system/files/231/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf/.

facilitate the safe growth of marketplace lending while fostering affordable access to credit for consumers and businesses. The Department's recommendations include the following:

- *Enhanced Protection for Small Business Borrowers.* The Department stated that more effective regulatory oversight could enable greater transparency in small business marketplace lending and lead to better outcomes for borrowers—particularly for small business loans under $100,000, which share common characteristics with consumer loans but are not entitled to the same consumer law protections.

- *Protecting the Borrower Experience.* The Department stated that all marketplace lenders should exercise prudence when engaging with borrowers in financial distress and should have in place comprehensive arrangements (including backup servicing plans) to provide for the continued servicing and collection of loans in the event the platform fails.

- *Promoting a Transparent Marketplace.* Certain RFI commenters stated that to improve its access to the capital markets, the industry will need to develop a wider investor base, an active and stable secondary market, and transparent securitization activity. The Department therefore recommended that the industry adopt (i) standardized representations, warranties, and enforcement mechanisms, (ii) consistent reporting standards for loan origination data and ongoing portfolio performance, (iii) loan securitization performance transparency, and (iv) consistent market-driven pricing methodology standards. The Department further recommended the creation of a private sector registry that is available to the public for tracking data on transactions, including the issuance of notes and securitizations, and loan-level performance.

- *Expanding Access to Credit for Underserved Borrowers*. The Department stated that for the industry to truly expand access to underserved markets, more must be done to serve borrowers who may be creditworthy but may not be scorable under traditional credit scoring models. The Department recommended that marketplace lenders consider partnering with Community Development Financial Institutions (*"CDFIs"*), which could be mutually beneficial as it would allow CDFIs to use the marketplace lender's technology and back-end operations to lower their costs and the marketplace lender would gain access to the CDFIs' knowledge of local credit markets.

- *Working Group for Interagency Cooperation.* Various aspects of marketplace lending and related financing activities by lenders are subject to regulation by a number of different federal and state agencies. The Department therefore recommended that regulators organize an interagency working group consisting of representatives of the Department, the CFPB, the FTC, the SEC, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Small Business Administration, and a representative of a state banking regulator, to consider the applicability of existing regulations to marketplace lenders, whether there are any gaps in the current regulatory structure, and the impact of nontraditional data on credit scoring models.

*U.S. Treasury Report on Financial Innovation.* In February 2017, President Trump signed Executive Order 13772 outlining core principles for the regulation of the financial system of the United States. The thrust

of the order was to simplify and reform laws and regulations inconsistent with the smooth operation of the financial system and to seek to streamline and reform those laws and regulations. In response to President Trump's administration establishing these principles for a regulatory framework to foster financial growth and stability by making regulation more efficient, the U.S. Department of the Treasury undertook a review of the financial system in an effort to determine what laws and regulations either enhanced or inhibited the provision of financial services. This process generated several reports, including one focusing on fintech issued in July 2018.[146] The report as it related to non-bank financial and fintech companies was generally supportive of establishing a more flexible regulatory framework that promotes innovation.

The report contained some 80 recommendations affecting the current regulatory framework relating to non-bank financial entities and innovation. These can be summarized in four general areas as follows: (1) adopting regulatory approaches that support the development of competitive technologies, (2) aligning or harmonizing the existing regulatory framework to combat fragmentation and allow for new business models enabled by financial technology, (3) updating outdated regulations affecting the products and services of non-bank financial institutions and (4) advocating regulation that embraces responsible experimentation and regulatory agility and that promotes American interests abroad while maintaining consumer protections and safeguarding the financial system.

In particular, and relevant to marketplace lending, the study endorsed several concepts including (1) the establishment of a regulatory sandbox to promote innovation, (2) updating the rules affecting partnerships between banks and non-bank firms to accommodate technological advances, (3) codifying the "valid when made" doctrine and the role of a bank as the true lender of loans it makes, (4) providing regulatory clarity for the use of data and algorithms in the underwriting process and (5) supporting the OCC's special purpose charter that could be attractive to fintech companies. The report also recommended that Congress enact a federal data security and breach notification law to protect consumer information and provide notification when a breach occurs.

Since the Treasury Department is not itself a regulator of marketplace lenders or banks, it does not have specific authority to cause its recommendations in this report to be enacted. As a result the pursuit of these recommendations was not clear or effective, although each federal agency seems to be pursuing its own course in these areas. Since the issuance of this report, the change of administrations in Washington in 2020 has impacted the priorities and objectives of these and similar initiatives.

In November 2022, the United States Department of the Treasury issued a report on banks and fintechs. The report concluded that partnerships between banks and financial technology companies are positive for consumers when conducted responsibly. Of importance was the observation by Treasury Secretary

146 *See* U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities—Nonbank Financials, Fintech, and Innovation, available at https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf/.

Janet Yellen that under existing law and regulation, regulators can both encourage competition and protect consumers. The report recommended that regulators finalize proposed guidance on how banks should manage third-party relationships and service providers. This includes bank oversight and protective contractual provisions with service providers including fintechs.

#### *4. Federal Reserve*

Following other bank regulators, the Board of Governors of the Federal Reserve System issued a policy statement in February 2023 concerning cryptocurrency assets. The activities of state member banks and their subsidiaries are limited to cryptocurrency activities that are permissible for national banks.[147] This aligns what state Fed member banks can do in this arena with guidance issued by the OCC for national banks, including all terms, conditions and limitations placed on national banks by that activity.[148] As with other banking agency guidance, crypto assets may only be held as principal. Any bank seeking to issue a stablecoin would need approval (*i.e.,* a supervisory nonobjection) and be required to follow all restrictions placed on national banks by the OCC. State member banks may offer traditional banking services such as deposit or lending products to crypto companies. Custodial safekeeping for crypto assets is allowed if conducted in a safe and sound manner and in compliance with applicable anti-money laundering and consumer protection laws. However, the policy statement cautioned against having business models or exposures concentrated in the crypto asset industry.[149]

#### *5. Consumer Financial Protection Bureau*

Some prior actions of significance by the CFPB are noted below.

***Arbitration Rule Thwarted.*** After years of study, receiving comments and holding hearings, on July 10, 2017, the CFPB promulgated its Arbitration Agreements Rule (the *"Arbitration Rule"*), which prohibited the inclusion of class action waivers in arbitration clauses in agreements for consumer financial products and services and imposed related disclosure and reporting requirements.[150] Compliance with the Arbitration Rule would have been required by March 19, 2018. However, a joint resolution was passed by both houses of Congress overturning the Arbitration Rule pursuant to the Congressional Review

147 The Policy Statement also applies to non-insured state member banks such as trust companies.

148 If a proposed activity is not permissible for a national bank, a bank must obtain the Federal Reserve Board's prior permission under Regulation H.

149 The timing of the guidance is interesting given that within a month of its issuance, Silvergate Bank, a primary lender to the crypto industry, ceased operations. This was in conjunction with the withdrawal of funds from crypto products and services and dislocation in the industry. Not long after, Silicon Valley Bank and Signature Bank, significant providers of financial services to the fintech sector, failed and were placed into receivership with the FDIC. Hence the warning on overexposure to a market segment was timely if not foreshadowing.

150 Prior to issuing the Arbitration Rule, the CFPB conducted an arbitration study and published a lengthy report of its findings in March 2015. Then, on May 5, 2016, the CFPB issued its proposed arbitration rule for public notice and comment. The CFPB received nearly 13,000 comments on the proposed rule, with one of the main criticisms being that the proposed rule was not justified based on the CFPB's own arbitration study.

Act.[151] On November 1, 2017, President Trump signed the joint resolution, effectively nullifying the Arbitration Rule and preventing the CFPB from issuing any similar rule in the future. Many lenders, including marketplace loan programs, utilize arbitration agreements or clauses in their loan agreements, and this action has been viewed as a victory that will allow these lenders to retain the ability to use and enforce arbitration agreements and potentially avoid class action litigation. However, it is possible for Congress to pass legislation that could impact this result.[152]

***Project Catalyst Issues First No-Action Letter.*** On September 14, 2017, the CFPB issued its first "no-action" letter to a marketplace lender.[153] The letter was part of the CFPB's Project Catalyst, which reviews requests from companies seeking to develop consumer-friendly innovations or products in areas where there is regulatory uncertainty.[154] The marketplace lender who requested the letter was using alternative data such as education and employment history in its credit underwriting and pricing decision models, and sought the CFPB's agreement that it would not take supervisory or enforcement action under the Equal Credit Opportunity Act in connection with the marketplace lender's use of such data.[155] The CFPB agreed, recognizing that the use of alternative data could potentially make credit more accessible and affordable to some segments of the population. The CFPB did, however, require the marketplace lender to agree to ongoing reporting to the CFPB concerning its practices to allow the bureau to understand the impact of alternative data on credit decision-making and to mitigate risk to consumers.[156] We note that the no-action letter is specific to the facts and circumstances of this particular company and should not be viewed as permission to utilize alternative data in other lending models without an appropriate evaluation of fair lending risks or a similar determination being made by the CFPB. This no-action letter nonetheless showed the willingness of the CFPB at that time to consider emerging technologies in a manner favorable to their development while providing a degree of regulatory certainty for technological innovations in the financial services industry. In June 2022, the CFPB terminated this no-action letter despite the lender's reported success in providing lower rates and

151 The vote in the United States Senate was 50-50 for and against disapproval, requiring Vice President Pence to cast the tie-breaking vote for disapproval. The law provides Congress within a certain time parameter to overturn agency regulations. 5 U.S.C. § 801 *et seq*. This law was later used as a means of overturning the "true lender" regulation enacted by the OCC in 2020. Legislation has been introduced in Congress that would prohibit arbitration clauses which has not been acted upon.

152 Consumer groups are also asking the CFPB to re-visit rulemaking in this area, despite the limitations imposed by the Congressional Review Act.

153 The letter was issued to Upstart Network, Inc. on Sept. 14, 2017. The letter is available at: http://files.consumerfinance.gov/f/documents/201709_cfpb_upstart-no-action-letter.pdf/.

154 The agency has dropped the name Project Catalyst, but the CFPB's renamed and repurposed Office of Competition and Innovation entertains applications related to innovation.

155 The use of alternative data in credit underwriting is discussed further below under "Consumer Protection Laws—Fair Lending and Related Laws."

156 The legal concern is that use of alternative data, newly derived algorithms and automated machine decision making can have the effect of circumventing fair lending laws and unintentionally result in discrimination against persons protected by the ECOA and other similar laws. The data the CFPB will receive from the marketplace lender in connection with the no-action letter will help the bureau evaluate whether new modeling techniques potentially result in discrimination.

higher acceptance. The CFPB then abandoned its no-action letter posture.[157] However, the Biden-led CFPB indicated that it will scrutinize utilization of technology for potential discriminatory effects.

***PHH and Constitutional Challenges to the CFPB Structure—2016 Decision.*** The much-anticipated decision in *PHH Corporation v. Consumer Financial Protection Bureau* was handed down by the U.S. Court of Appeals for the D.C. Circuit, *en banc*, on January 31, 2018. This case originated in 2014 with an administrative enforcement action brought by the CFPB against PHH, a New Jersey-based mortgage lender, alleging violations of the Real Estate Settlement Procedures Act (*"RESPA"*). The CFPB alleged that despite relying on prior regulatory guidance, which was widespread industry practice, PHH violated Section 8 of RESPA by referring customers to mortgage insurers, who in turn bought reinsurance from one of PHH's affiliates. In the initial administrative enforcement action, the CFPB imposed a $6.4 million penalty for PHH's RESPA violations. PHH appealed the decision to the CFPB's then director, Richard Cordray, who increased the penalty to $109 million (primarily related to extending relief beyond RESPA's statute of limitations period). PHH then appealed directly to the Court of Appeals for the D.C. Circuit.

The court's 2016 decision[158] analyzed three questions and ruled against the CFPB on each one: (1) whether the CFPB's structure is constitutional, (2) whether the CFPB properly applied RESPA in finding a violation, and (3) whether the statute of limitations in RESPA applies in administrative actions as well as court proceedings. As expected, following the court's decision the CFPB petitioned for a rehearing *en banc* by the full D.C. Circuit and the court granted the bureau's request, effectively vacating its 2016 decision.

***CFPB Structure Found Constitutional by Appeals Court***. The subsequent decision in *PHH Corporation v. Consumer Financial Protection Bureau* was issued on January 31, 2018,[159] almost a year after the CFPB petitioned for a rehearing by the Court of Appeals for the D.C. Circuit, *en banc*. The court issued a 250-page opinion finding that the single-director structure of the CFPB was constitutional and that its director could only be fired for inefficiency, neglect of duty or malfeasance in office, and not at the will of the President of the United States. This, the court stated, allowed the CFPB to remain one step removed from political winds and the President's will. The court also threw out the $109 million penalty previously awarded against PHH, returning the case to the CFPB for further consideration. The court found that this penalty, which was calculated based on the CFPB's retroactive application of certain federal laws beyond the statute of limitations, violated PHH's due process rights—thus confirming that

157 The CFPB is revamping its processes to encourage further experimentation with innovation in disclosures and other matters. The U.S. Treasury Report of July 2018 supports clarifying and establishing a federal regulatory approach to the use of alternative data.

158 *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F.3d 1 (D.C. Cir. 2016).

159 *PHH Corp. v. Consumer Fin. Prot. Bureau*, 881 F.3d 75 (D.C. Cir. 2018).

the CFPB is subject to the statutes of limitation prescribed by federal law in its enforcement actions.[160] The CFPB dismissed the case against PHH. However, there are other lawsuits pending that challenge the constitutionality of the CFPB which ultimately required the United States Supreme Court to decide the issue.[161]

*Constitutionality of the Consumer Financial Protection Bureau (CFPB) Challenged Again.* The CFPB has been a source of controversy since its inception. However, one culmination of the brouhaha was a decision by the United States Supreme Court in June 2020.[162] In 2017, a debt collection law firm, Seila Law, was issued a civil investigative demand by the CFPB. The firm refused to comply, based on the argument that placing the agency's authority in a single director who could only be removed for cause violated the separation of powers doctrine and was therefore unconstitutional. The CFPB went to federal court to enforce its demand. Both the district court and the Ninth Circuit Court of Appeals sided with the CFPB. Despite the fact that there was no split in authority in the circuits, the United States Supreme Court nonetheless agreed to hear the case.[163] This fact signaled a potential reversal.

The Supreme Court held that the structure of the CFPB—one director who could only be removed for cause—violated the Constitution's separation of powers doctrine. However, the court took "a scalpel rather than a bulldozer" to the CFPB, finding that this in and of itself did not make the agency unconstitutional. This was based on a provision in the law that created the CFPB that allowed severability, allowing the court to invalidate the issue of the director's removal from the unconstitutionality of the entire agency. Thus, the court reined in the power of the director without invalidating the agency, leaving the CFPB and its powers in place.[164]

The Supreme Court did not address how its holding affects prior agency regulations and actions. The court noted that individual actions should be handled by the lower courts on a case-by-case basis. Thus, the court left open the potential for continued uncertainty and litigation in those matters. On July 7, 2020, the CFPB did provide a ratification of all of its past actions, which made those challenges more

160 By law, the CFPB cannot appeal the decision, and PHH did not appeal the decision. The CFPB subsequently dismissed the action.

161 In a case pending at the Second Circuit Court of Appeals, the structure of the CFPB was found to be unconstitutional by the lower court. It is on appeal to the Second Circuit. *Consumer Fin. Prot. Bureau v. RD Legal Funding LLC,* Case No. 18-2743 (2d Cir.). Other cases have raised this issue in the Fifth (*Consumer Fin. Prot. Bureau v. All American Check Cashing,* Case No. 18-60302) and Ninth Circuits (*Consumer Fin. Prot. Bureau v. Seila Law,* Case No. 17-56324), and it is included as an issue to be decided in the *Consumer Fin. Prot. Bureau v. CashCall* case in California discussed in the "Recent Developments in Marketplace Lending Regulation" section and below. The constitutional issue is being raised by defendants in enforcement actions.

162 *Seila Law LLC v. Consumer Fin. Prot. Bureau*, No 19-7 (U.S. Sup. Ct. June 29, 2020), 591 U.S. ____ (2020), 140 S. Ct. 2183 (2020).

163 As discussed later, the D.C. Circuit agreed with the Ninth Circuit. *See PHH Corp. v. Consumer Fin. Prot. Bureau,* 881 F.3d 75 (D.C. 2019).

164 Because a U.S. president can then remove the Director of the CFPB at will, if there is a change in administrations, the existing director could be removed at any time by the new president. This could mean changes in how the CFPB operates or alter its enforcement objectives.

difficult.[165] In August 2020, the CFPB also filed a brief in the *Seila Law* remand at the Ninth Circuit, asking it to enforce the civil investigative demand.[166] At least one other case has already been stayed subject to the Ninth Circuit's determination of the remand proceeding.[167] The appeal was decided in favor of the CFPB and the case was not appealed. Another challenge to the constitutionality of the CFPB is described in "Recent Developments in Marketplace Lending Regulation." There, the CFPB was found to be constitutionally funded. However, challenges are still being made on this issue.

***Leadership Changes at CFPB Brings Lawsuit, New Focus.*** The agency has never been free from controversy. One such saga involves the changes of director of the body. On November 24, 2017, CFPB Director Richard Cordray resigned to run for Governor of Ohio, an election he subsequently lost. Cordray had aggressively led the CFPB as its first director, and critics assailed him for engaging in "regulation by enforcement," *i.e.,* using enforcement actions as a means to circumvent the administrative process of issuing regulations. Cordray left on a contentious note, appointing Deputy Director Leandra English as acting director of the agency. Meanwhile, President Trump named his own interim director of the agency, Mick Mulvaney, who was serving as Director of the Office of Management and Budget and had been a harsh critic of the CFPB.

This jockeying for position led to English filing a lawsuit asking that she be declared the CFPB Director pursuant to the provision of the Dodd-Frank Act that states that the Deputy Director serves as Acting Director in the absence or unavailability of the Director.[168] The Trump administration defended the lawsuit, arguing that the president has the right to fill executive positions, including the CFPB directorship, under the Federal Vacancies Reform Act.[169] On November 28, 2017, the court denied English's request for a temporary restraining order to keep Mulvaney from exercising power as CFPB Director. The court also denied English's request for a preliminary injunction, which was appealed to the Court of Appeals for the D.C. Circuit. The case was dismissed after a new director of the CFPB, Kathy Kraninger, was confirmed by the U.S. Senate.[170]

In the interim, Acting Director Mulvaney effected a significant restructuring of the CFPB. In the CFPB's semi-annual report to Congress issued April 2, 2018, Mulvaney recommended statutory changes to the

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165 https://files.consumerfinance.gov/f/documents/cfpb_ratification_bureau-actions_2020-07.pdf

166 *Consumer Fin. Prot. Bureau v. Seila Law LLC,* Case No. 17-56324 (9th Cir.). Case decided Dec. 29, 2020.

167 *Consumer Fin. Prot. Bureau v. CashCall et al.*, Case No. 18-55407 (9th Cir. order issued Aug. 2, 2020). This case is discussed in detail later in this book.

168 *English v. Trump and Mulvaney,* C.A. No. 1:17-cv-02534 (D.D.C. 2017).

169 In addition, a federal credit union sought to block Mulvaney's appointment by filing suit in federal court in New York. *Lower East Side People's Fed. Credit Union v. Trump et al.*, No. 17-09536 (S.D.N.Y. Feb. 1, 2018). The court dismissed this case because it found that the credit union lacked authority to bring it.

170 Kraninger was confirmed on December 6, 2018. Legislation had been introduced during the prior Congress in the U.S. House of Representatives with bipartisan support to put the CFPB under a five-member commission rather than a single director. H.R. 5266—Financial Product Safety Commission Act of 2018. However, it was not acted upon and died with the end of the 115th Congress in January 2019. Later similar efforts have also stalled.

Dodd-Frank Act, including legislative approval of major CFPB rules. He indicated that the enforcement activities of the bureau will be curtailed, leaving enforcement to the federal banking agencies or the states, while rulemaking will take a higher priority.[171] The CFPB's fair lending office was relegated to an administrative function rather than an enforcement one.[172] Under Mulvaney, the CFPB issued a series of Requests for Information seeking industry and public input on a variety of subjects including its civil investigative demands, consumer complaint portal and how to improve the rulemaking process.[173]

### C. U.S. Supreme Court Finds CFPB Constitutional

#### *1. Fifth Circuit Ruling*

Almost since its inception the CFPB has been no stranger to challenges to its existence. There were earlier challenges to the structure of the CFPB, finding that while the makeup of the agency was invalid, its actions remained effective. However, in October 2022 the Fifth Circuit Court of Appeals ruled that the funding structure of the CFPB violated the Appropriations Clause of the United States Constitution.[174]

The original lawsuit brought by two trade associations challenged certain provisions of a rule promulgated by the CFPB in 2017 related to payday lending. The lower court granted summary judgment to the CFPB on all matters and the two trade associations appealed to the Fifth Circuit. The appeal was based on two theories: that the funding of the CFPB was unconstitutional and that the prior United States Supreme Court ruling that the agency was structured in violation of the Constitution made the rule invalid form inception. The Fifth Circuit denied many of the claims asserted by the trade groups but latched onto the argument to conclude that the funding mechanism contravenes the separation of powers doctrine of the United States Constitution.[175] The court reasoned that separation of powers requires Congress to have control over federal disbursements and, since the CFPB is not

171 In a January 24, 2018, staff memo, Mulvaney stated: "On regulation, it seems that the people we regulate should have the right to know what the rules are before being charged with breaking them. This means more formal rulemaking … and less regulation by enforcement."

172 The Office of Fair Lending was created by Section 1013 of the Dodd-Frank Act. Mulvaney's action stripped the office of its supervisory responsibilities and replaced them with advocacy and education efforts.

173 These RFIs are characterized on the CFPB website as "Calls for evidence" that the CFPB is fulfilling its proper function.

174 *Cmty. Fin. Servs. Ass'n of America, Ltd. et al. v. Consumer Fin. Prot. Bureau et al.*, Case No. 21-50826 (5th Cir. Oct. 19, 2022). The lower case was from the Western District of Texas, Case No. 1:18-cv-295. Pursuant to the Dodd-Frank Act, funding occurs through requests made the Director of the CFPB to the Federal Reserve subject only to a cap of 12% of the budget of the Federal Reserve. As a result, it bypasses any appropriations process by the U.S. Congress.

175 The court rejected claims that the rule was invalid due to its promulgation by a CFPB director insulated from removal from office by the President of the United States, that the rule was enacted in violation of the procedures set forth in the Administrative Procedure Act and exceeded its authority and was arbitrary and capricious, and that the CFPB in making the rule constituted an unconstitutional delegation of legislative power. The decision followed a concurring opinion in another case challenging the constitutionality of the CFPB where several judges found that the funding action was unconstitutional and that an underlying enforcement action should be dismissed. *Consumer Fin. Prot. Bureau v. All American Check Cashing, Inc. et al.,* Case No. 18-60302 (5th Cir. May 2, 2022).

subject to that process and receives funds from the Federal Reserve, it is not valid. In essence, the bureau could not engage in rulemaking because the rule was enacted based upon the use of unappropriated funds. The decision not only reversed the prior opinion but invalidated the entire rule.[176]

### *2. Appeal Heard by the Supreme Court*

Rather than seeking an *en banc* rehearing by the entire Fifth Circuit, the CFPB filed a writ of certiorari with the U.S. Supreme Court on November 14, 2022, asking for an expedited appeal. The trade groups opposed the CFPB's position but filed their own cross petition for certiorari in January 2023.[177] On February 27, 2023 the Supreme Court decided that it would hear the appeal of the CFPB, but not on an expedited basis.[178] The Supreme Court has also set a briefing schedule. It heard the case on October 6, 2023, with a decision rendered in May 2024.

| The Supreme Court finds the CFPB to be constitutional. |
|---|

In the interim, the Second Circuit Court of Appeals ruled that the CFPB's funding structure does not violate the Appropriations Clause of the Constitution.[179] The Second Circuit did not follow the Fifth Circuit's reasoning in a case involving a civil investigative demand issued to a law firm. The panel found the funding authorized by Congress, which had been given control over the CFPB budget outside of the appropriations process. The CFPB asked a New York federal judge to restart another case that had been subject to a stay pending resolution of the Fifth Circuit proceeding at the United States Supreme Court as a result of the Second Circuit ruling.[180] The judge ruled in April 2023 that the case would remain paused until the Supreme Court rules on the matter.

Almost immediately after the Fifth Circuit decision, litigants with the CFPB or recipients of civil investigative demands filed for stays of the relevant action pending additional review or filed motions to dismiss or added additional defenses to invalidate the actions of the CFPB based on the funding structure of the agency.[181]

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176 The Fifth Circuit panel did not find anything wrong with the promulgation of the rule itself, but found only that it was enacted based on the invalid funding structure.

177 In separate briefs, 38 attorneys general (22 Democrats on one brief and 16 Republicans on another brief) urged the Supreme Court to grant the petition so that "chaos" could be averted. The Democrats argued against dire consequences if the ruling were upheld while Republicans stated that a quick answer was needed, but that the CFPB should not be allowed to act as a rogue agency.

178 The Supreme Court Docket Number is 22-448. The Supreme Court denied the petition of the trade associations.

179 *Consumer Fin. Prot. Bureau v. Law Offices of Crystal Moroney, P.C.*, Case No. 20-3471 (2d Cir. Mar. 23, 2023).

180 *Consumer Fin. Prot. Bureau v. MoneyGram Int'l, Inc.*, Case No. 1:22-cv-03256 (S.D.N.Y.).

181 For example, Populus Financial Group, Inc., filed a motion to dismiss a CFPB enforcement action against its ACE Cash Express unit in federal district court in Texas. It also filed a motion to stay the proceedings pending the Supreme Court appeal in the Community Financial Services Association case. The stay was granted by the Supreme Court in October 2022. *Consumer Fin.*

The CFPB brought an action against an online lender for purported violations of the Military Lending Act.[182] The defendant claims that the suit fails to state a claim and offered the defense that the agency is unconstitutional.

The CFPB strongly asserted that the Fifth Circuit ruling does not affect its ability to issue civil investigative demands or to bring enforcement actions. In December 2022 the CFPB denied a petition by a debt collection agency to vacate a civil investigative demand issued by the bureau. However, in proceedings outside of the agency itself, litigants routinely requested stays of proceeding until the Supreme Court ruled on the matter, grinding many of these actions to a halt.[183]

As a result, many of the enforcement proceedings brought by the CFPB or civil investigative demands issued by the CFPB were being stayed until resolution of the constitutionality questions surrounding the CFPB.[184]

### *3. U.S. Supreme Court Decision Upholds Funding Structure*

On May 16, 2024, in a 7-2 decision, the Supreme Court ruled in favor of the CFPB and found that its funding structure was constitutional and did not violate the Appropriations Clause of the Constitution.[185] The CFPB created by the Dodd-Frank Act by statute receives its funds from the earnings of the Federal Reserve System. The CFPB determines how much to receive, capped at 12% of the total operating expenses of the Federal Reserve. This statutory grant was challenged as not being an appropriation from Congress as required by the Constitution. Justice Clarence Thomas wrote the opinion and found that the Dodd-Frank funding mechanism being passed by Congress authorized the grant of money albeit not directly and therefore did not violate the Appropriations Clause.[186] The Supreme Court reasoned that Congress need only identify the source of public funds and authorize the expenditure of those funds for designated purposes to be valid. This finding also avoided the potential

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*Prot. Bureau v. Populus Fin. Grp., Inc.*, Case No. 3:22-cv-01494 (N.D. Tex.). *See also Consumer Fin. Prot. Bureau et al. v. Commonwealth Equity Grp., LLC et al.*, Case No. 1:20-cv-10991 (D. Mass).

182 *Consumer Fin. Prot. Bureau v. MoneyLion Techs. Inc. et al.,* Case No. 1:22-cv-08308 (S.D.N.Y. filed Sept. 29, 2022).

183 For example, in a repeat offender case, a credit reporting agency asked the Supreme Court to stay the action. *Consumer Fin. Prot. Bureau v. TransUnion et al.,* Case No. 1:22-01880 (N.D. Ill.). On April 13, 2023, the Supreme Court denied the motion to stay, claiming that the potential consumer harm from violations outweighed the wait period in order to receive a decision from the Supreme Court.

184 *See, e.g., Consumer Fin. Prot. Bureau v. Daniel A. Rosen, Inc.*, Case No. 2:22-cv-06432 (D.N.J.), and *Consumer Fin. Prot. Bureau v. Daniel A. Rosen, Inc. d/b/a/Credit Repair Cloud et al.*, Case No. 2:21-cv-07492 (C.D. Cal.) (challenges to CFPB subpoenas).

185 *Consumer Fin Prot. Bureau et al. v. Cmty. Fin. Servs. Ass'n of America, Ltd. et al.*, Case No 22-448, 601 U.S. ____(2024).

186 Justice Thomas wrote: "Under the Appropriations Clause, an appropriation is a law that authorizes expenditures from a specified source of public money for designated purposes." Further, he stated, "The statute that provides the bureau's funding meets these requirements." Thus, receiving money through the Federal Reserve rather than Congress is valid. The dissent noted: "The Court upholds a novel statutory scheme under which the powerful Consumer Financial Protection Bureau (CFPB) may bankroll its own agenda without any congressional control or oversight."

challenge to the funding of other banking regulators.[187] An already assertive and aggressive regulator, the decision provides a basis for the CFPB to continue and increase its regulatory, supervision and enforcement activities.[188] Soon after the decision, the agency announced plans to increase its enforcement staff. In addition, several actions that had been stayed pending the outcome of the Supreme Court's decision will come to life and continue onward.

#### *4. New Theories Challenge the Validity of the CFPB*

But the challenges to the CFPB are not over yet! Some enforcement actions are seeking to be dismissed on the basis that despite the Supreme Court ruling, the CFPB funding still violates the standard enumerated in Dodd-Frank. The argument is that under the Dodd-Frank Act, the CFPB may only receive funds from the "earnings" of the Federal Reserve. However, the Federal Reserve has lost money since September 2022, hence the basis of the claim that, absent earnings, the CFPB lacks funding and cannot act. Some enforcement actions are being challenged based on this theory.[189] In one instance, a company proactively sued the CFPB seeking a judgment that the CFPB lacked authority over the company.[190] It is anticipated that other challenges will be made on this basis and that, again, the higher courts may be called upon to make yet another decision on the constitutionality of the CFPB.[191] Given the Supreme Court ruling, however, some courts have been reluctant to give credence to this new theory.

***Enforcement Action Against Lead Aggregator.*** On September 6, 2017, the CFPB issued a consent order against an online lead aggregator imposing a $100,000 penalty for selling leads to lenders where the resulting loan was either made by an unlicensed lender, imposed interest rates in excess of applicable usury limits, or was void. [192] The CFPB cited these activities as an abusive practice and required the lead aggregator to engage in efforts to ensure that its leads do not result in void loans and monitor the lenders to whom it sells leads and obtain copies of their lending licenses. The use of lead generation

187 The federal banking agencies—the FDIC, the OCC and the Federal Reserve—also receive funding in a similar way and through fees they collect rather than a direct appropriation from Congress. Had the CFPB funding structure been found to violate the appropriations process, the validity of the other banking agencies would also be in doubt and subject to challenge.

188 After the decision the Director of the CFPB stated that the agency will be "firing on all cylinders" as a result.

189 *See, e.g., CFPB v. Heights Fin. Holding Co. et al.*, Case No. 6:2023-cv-04177 (D. S.C.) (motion for judgment on the pleading in allegations of unfair practices by churning loans). *See also, CFPB v. Solo Funding, Inc.*, Case No. 2:24-cv-04108-RGK-AJR (C.D. Cal. filed May 17, 2024) (alleging that tips or donations on cash advances are interest, leading to an inflated APR).

190 *Acima Digital, LLC et al. v. Consumer Fin. Prot. Bureau*, Case No. 4:24-cv-00662-SDJ (E.D. Tex. filed July 22, 2024). Interestingly, just a few days later the CFPB sued the Acima companies. *Consumer Fin. Prot. Bureau*, Case No. 2:24-cv-00525-DBB (D. Utah filed July 26, 2024).

191 As noted in the next session, a regulation was challenged on this basis, but that claim was withdrawn in order to allow an appeal. But in addition to enforcement actions, regulations, civil investigative demands and subpoenas may be subject to challenge under this theory.

192 The full text of the CFPB's consent order entered against Zero Parallel, LLC, is available at: http://files.consumerfinance.gov/f/documents/201709_cfpb_zero-parallel-llc_consent-order.pdf. In a related action, the CFPB proposed to fine the owner of Zero Parallel $250,000 for similar illegal actions.

and aggregation is coming under increasing regulatory scrutiny, including with respect to state licensing, unfair or deceptive practices claims, and sharing of consumer information.

***CFPB on Marketplace Lenders.*** On March 7, 2016, the Consumer Financial Protection Bureau announced that it was accepting consumer complaints about online marketplace lenders, giving consumers "a greater voice in these markets and a place to turn to when they encounter problems." The CFPB also issued a bulletin to provide consumers with information on marketplace lending, including guidance on shopping for a loan. Significantly, the CFPB noted in its bulletin that while marketplace lending is relatively new, marketplace lenders are subject to the same state and federal laws as other lenders.

Although consumers have been able to file complaints regarding marketplace lenders with the CFPB since July 2011, it seems the CFPB issued this press release to raise awareness in the industry and among consumers that the bureau might seek to expand its oversight in this area. The CFPB has used complaint data to identify areas that require additional regulatory guidance and rulemaking and to direct its investigations and enforcement actions. Marketplace lending has not generated an inordinate amount of complaints. The CFPB issued Requests for Information on the efficiency and effectiveness of its consumer complaint reporting and enforcement processes.[193]

The CFPB may still prosecute enforcement actions against online lenders.

Although actions of the bureau remain provocative, during the first Trump administration the agency moved away from regulation by enforcement to supervision but under the Biden administration returned to a more aggressive enforcement posture. As highlighted in the "Recent Developments in Marketplace Lending Regulation" section, the second Trump administration is curtailing supervisory and enforcement efforts at the CFPB. Nonetheless, the CFPB still undertakes enforcement actions when it deems them warranted. Some relevant ones are outlined below.

***Enforcement Action Against Online Foreign Lender.*** In February 2019, the CFPB lodged a complaint and settlement agreement with the Southern District of New York against a non-U.S. online payday lender based in Canada and Malta.[194] The lender and its related entities were cited for making misrepresentations to borrowers, claiming that they had to repay loans even though those loans violated U.S. state laws on lender licensing and usury.[195] The lender also falsely stated that the loans were not subject to U.S. laws and used a foreign governing law provision. In addition, the lender took wage assignments and made misrepresentations about punishments that allegedly would result from

193 *Request for Information Regarding Bureau Public Reporting Practices of Consumer Complaint Information*, 83 Fed. Reg. 9499 (Mar. 6, 2018); *Request for Information Regarding Bureau Enforcement Processes*, 83 Fed. Reg. 5999 (Feb. 12, 2018).

194 *Consumer Fin. Prot. Bureau v. NDG Fin. Corp. et al.*, Case No. 15-cv-05211 (S.D.N.Y. filed Feb. 4, 2019).

195 Since the CFPB cannot enforce state laws dealing with licensing and usury, the fact that the online lender made loans in violation of those laws provided the basis of the CFPB claims relating to misrepresentation of the applicability of state law to those loans.

nonpayment. The entities were barred from doing business in the United States in any manner, including collection of any outstanding loan made to a U.S. resident. Consumer groups were disappointed that the CFPB action did not require payments to affected customers or any type of restitution. However, this proceeding is a lesson to foreign-based Internet lenders that lending to U.S. citizens requires compliance with U.S. law, including state licensing and usury laws. Nor can the use of a foreign jurisdictional clause circumvent consumer protection laws that are applicable to lending to U.S. residents.

> Any lending to U.S. residents over the Internet, even from foreign countries, requires compliance with U.S. legal requirements including any applicable licensing and usury laws.

***Enforcement Actions on Electronic Transfers.*** Online lenders often utilize electronic fund transfers to collect the payments due on their loans. Electronic fund transfers are subject to the Electronic Fund Transfer Act and its implementing Regulation E. Generally, the law and regulation require the lender to obtain the consumer's consent before debiting the consumer's deposit account, and special requirements apply to recurring transfers. In January 2019, the CFPB entered into a consent order with an online marketplace lender.[196] The CFPB found that the platform had debited borrowers' bank accounts without proper authorization. While borrowers may have provided an authorization as to one account, the platform was debiting payments from different accounts that had not been authorized for withdrawals. The CFPB also found that the lender failed to honor loan extensions that had been given to borrowers. In addition to prohibiting the debiting of consumer bank accounts without prior authorization, the consent order required payment of a $3.2 million penalty. It appears that electronic fund transfers are an area of focus by the CFPB.[197] In an unrelated action against a bank, the CFPB settled a complaint for failure to implement stop-payment requests on preauthorized fund transfers and for failure to conduct proper error-resolution investigations. The settlement resulted in $12 million in restitution and a $3.5 million civil penalty.[198]

196 *In re Enova Int'l, Inc.*, CFPB File No. 2019-BCFP-0003 (Jan. 25, 2019). On November 15, 2023, the CFPB issued an additional order against the company for continued violations of the 2019 Order. Enova paid a $15 million penalty and redress to consumers for making withdrawals from deposit accounts without permission. The agency banned the company from making loans of 45 or fewer days and required the entity to tie executive compensation to compliance.

197 In 2015, the CFPB brought an enforcement action against an online payday lender. *In re Integrity Advance LLC et al.,* Adm. Proc. File No. 2015-CFPB-0029 (Mar. 15, 2015). Although there were allegations of failure to accurately disclose the costs of the loan, the agency also alleged violations of Regulation E for conditioning the loan on electronic payment and continuing to debit borrower accounts after revocation of the debit authorization by borrowers. The recommended decision includes over $13 million in penalties and remains pending before the CFPB.

198 *In re USAA Fed. Savs. Bank*, CFPB File No. 2019-BCFP-0001 (Jan. 3, 2019).

Online lender practices relating to electronic funds transfers from borrower accounts have been subject to scrutiny. Borrowers cannot be compelled to pay by electronic means and special rules apply to recurring transfers.

***Office of Innovation and Regulatory Sandbox Changed.*** The CFPB issued only one no-action letter under its originally named Project Catalyst (which the bureau had designed to promote innovation in financial products and services) and subsequently rescinded the letter. In 2018, the CFPB announced that it would be revising its policies and established an Office of Innovation to promote financial innovation. It focused on revising its no-action letter policy to increase participation by entities wanting to offer new and innovative products and services in the marketplace and streamline its application and review process, focusing on potential benefits to consumers and the control of potential risks. The agency also proposed a "regulatory sandbox" to give companies the opportunity to test new financial products, while receiving relief from certain regulatory requirements. The CFPB also established a trial disclosure program to encourage the use of alternate disclosures on a trial basis, which the bureau terms a "disclosure sandbox." The Office of Innovation was to work with the Global Financial Innovation Network (*"GFIN"*) to work with regulators in other countries with respect to innovation and new ideas on a cooperative basis. In May 2022, the CFPB replaced the Office of Innovation with the Office of Competition and Innovation, signaling a change in emphasis away from technology assistance.

***Use of Alternative Data.*** The first "no-action" letter issued by the CFPB related to the use of alternative data and artificial intelligence.[199] The letter required monitoring by the CFPB and reporting from the non-bank fintech. In August 2019, the CFPB released performance metrics indicating that 30% more loans were approved when using alternative data. The CFPB stated this expanded access to credit when compared with traditional models. In addition, annual percentage rates on approved loans were lowered by 16% using alternative data when compared to traditional models. The CFPB also indicated that the alternative data benefited multiple demographic groups. More recently, leadership at the CFPB has been critical of machine learning and the use of artificial intelligence and alternative data as being potentially discriminatory. Ultimately, the no-action letter was terminated in June 2022 and no additional types of decisions have come out of the CFPB.

***Abusive Practices.*** In early 2020, the CFPB outlined how it defines abusive practices when overseeing companies.[200] The CFPB said it would challenge conduct as "abusive" only when the harm to consumers outweighs the benefit. It stated that duplicative charges would not be issued against companies as being both abusive and unfair or deceptive. The agency also said it will seek monetary relief where there has been a lack of good faith effort to comply with applicable law. Less than a year later, in March 2021, the CFPB rescinded this standard and in November 2023 issued new guidance, which is discussed below.

199 The no-action letter was issued to Upstart Network, Inc., a California fintech firm. It was terminated in June 2022.

200 The Dodd-Frank Act added the concept of abusive conduct to what the CFPB could enforce, including the more common and better defined unfair or deceptive practices. Prior CFPB actions used this to prohibit a variety of practices.

This view of what is abusive is likely to be interpreted differently as different administrations and directors push their agendas at the agency.

***Civil Investigative Demands.*** The CFPB started investigations against some fintechs. In February 2021, PayPal told investors that the CFPB was investigating the collection practices of Venmo, a mobile money transfer service. In March 2021, it was also disclosed in an SEC filing that an online consumer lender, Oportun, Inc., was being investigated for debt collection practices and pandemic-related dealings with borrowers. Also publicly disclosed in March 2021 was that the CFPB issued a civil investigative demand to Opportunity Financial, LLC, an online lender, investigating its compliance with the Military Lending Act. That proceeding was based on a consumer complaint.[201] Until January 2025 the CFPB continued to use civil investigative demands to investigate consumer complaints and other perceived compliance issues both generally and as to fintechs. Under Acting Director Vought, CFPB actions have been under review and many have been terminated.

***Enforcement Against Point-of-Sale Platform.*** In July 2021, the CFPB entered a consent order against GreenSky, LLC.[202] GreenSky is a fintech lending platform that originates consumer loans through a point-of-sale merchant network. The CFPB alleged that contractors and merchants were able to facilitate and benefit from loans from consumers who did not request or authorize the loans, making it an unfair practice and violating the law. In addition, the platform received over 6,000 complaints from consumers concerning unauthorized loans, some becoming aware of them from credit reports, billing statements, or collection activity. The order requires refunding or canceling some $9 million in loans and the company was hit with a $2.5 million civil money penalty. The company must also implement a complaint management program to prevent a recurrence of the situation. The action highlights the challenge of programs that work with third-party merchants and that require appropriate controls, merchant training and oversight, and a robust compliance management program.

***Fintech Halts Lending Due to CFPB Action.*** In December 2021, the CFPB announced that an online fintech agreed to halt new lending activity and collection of some outstanding loans in order to resolve a pending lawsuit alleging that it continued to engage in the deceptive marketing practices that were the subject of a 2016 CFPB order.[203] The CFPB also cited the company for violation of fair lending regulations. The bureau claimed that the company misrepresented to consumers that paying off loans would result in lower interest rates and larger loan amounts, which often did not materialize. The agency also claimed that thousands of adverse action notices failed to accurately describe the main reasons why loan applications were denied, as required by the ECOA and Regulation B. The CFPB imposed a

201 At the time of writing, no formal actions have been filed as to any of these companies under investigation.

202 *In re Greensky, LLC*, CFPB File No. 2021-CFPB-0004 (July 12, 2021).

203 *Bureau of Consumer Fin. Prot. v. LendUp Loans, LLC*, Case No. 4:20-cv-08583-JSW (N.D. Cal. filed Jan. 20, 2021). The CFPB also sued LendUp in 2020 for violations of the Military Lending Act and was awarded a judgment in that action.

$100,000 penalty based on the company's inability to pay the fine. However, the CFPB press release noted that the company was "backed by some of the biggest names in venture capital."

> Marketplace lenders do not expect strong enforcement actions, particularly from the current CFPB, but state attorneys general may enforce consumer protection laws.

***Proposal on Abusive Acts or Practices***. On March 16, 2022, the CFPB announced that it had revised its examination manual to identify discrimination as a potential unfair, deceptive, or abusive act or practice (*"UDAAP"*) in addition to being a violation of fair lending laws including the ECOA.[204] While this pronouncement reiterated the agency's increased focus on eliminating bias in the granting of credit, this move is seen as expanding the definition of a UDAAP to go beyond what is currently covered under fair lending laws so as to allow similar claims that relate to virtually every aspect of the credit process. For example, it would allow the CFPB to prohibit discrimination in marketing and advertising activities related to credit, including demographic research and analysis. The examination manual targets algorithms, automated decision-making, and other technological tools for examination for UDAAP risk. Customer service is also mentioned in the revisions, citing a possible UDAAP if representatives either improperly favor or disfavor customers of certain demographics, including responses to calls from consumers with limited English proficiency. Several trade groups brought suit against the CFPB asserting that this change was not properly authorized by the Administrative Procedure Act and that the agency exceeded its statutory authority.[205] In September 2023, a federal court in Texas granted summary judgment to the trade groups, finding that the CFPB had exceeded its statutory authority in making the exam manual change and had unlawfully expanded the statutory definition of "unfairness." Although the CFPB revised the exam manual and deleted the added reference, it appealed the decision of the lower court to the Fifth Circuit Court of Appeals. In May 2025 the Fifth Circuit dismissed the appeal based on a joint stipulation of the parties.

> An activist CFPB that targeted non-banks, emphasizing UDAAP and regulation, by enforcement, appears to have given way to a much reduced agency.

On April 3, 2023, the CFPB issued a Policy Statement on Abusive Acts or Practices. This guidance is to provide information and hopefully clarification on how the CFPB will interpret what is abusive under the Consumer Financial Protection Act, which has been a source of confusion and disagreement since the law's enactment.[206] Until this time, the CFPB had failed to define what would constitute an abusive act or practice but would seek to define it through enforcement actions, often criticized as being regulation

204 CFPB Press Release, CFPB Targets Unfair Discrimination in Consumer Finance (Mar. 16, 2022).

205 *U.S. Chamber of Commerce et al. v. Consumer Fin. Prot. Bureau*, Case No. 6:22-cv-00381 (E.D. Tex.).

206 While federal banking regulators and the Federal Trade Commission have authority to police unfair and deceptive acts and practices, the Dodd-Frank Act included an additional term, by adding abusiveness into the mix and putting the CFPB in charge of that. In 2020 the CFPB issued a policy aimed at defining abusive behavior as that which was violative of law.

by enforcement. The proposal provides examples of what might be an abusive act or practice. For example, omissions as well as actions can be deemed to be abusive, such as failing to provide material information to a consumer such that it interferes with the consumer's ability to understand a transaction. The bureau indicates that prices, limitation of benefits or consequences of default are the types of information that consumers need to know and omission from product terms or disclosures could therefore be abusive. Taking advantage or profiting from things such as a gap in understanding, unequal bargaining power or reliance could be abusive. There may also be a violation where a consumer's lack of understanding of risk or cost or conditions of a financial product is unreasonable. The bureau could bring an action if even a small number of consumers lack understanding of a product and as a result they are taken advantage of. The guidance is nonbinding and not legally enforceable, although it will drive the actions that the CFPB may take in this arena. Early critics of the proposal note that the CFPB is acting too broadly and will not require a showing of substantial injury to establish liability so a practice that causes no harm could still be deemed to be abusive. As a result, vagueness and uncertainty will still exist as to the definition and implementation of the abusiveness standard.[207] In May 2025, the CFPB rescinded this guidance.

***RFI on Data Brokers.*** In March 2023, the CFPB issued a Request for Information (*"RFI"*) about entities that collect and sell consumer data, including data brokers, data aggregators and platforms. The intent of the request is to provide the CFPB with knowledge of the industry and its business models in order for the CFPB to determine if such businesses are covered by the Fair Credit Reporting Act of other federal statutes. The information collected will also help determine whether there is harm being inflicted on consumers and whether regulation needs to occur. The focus is on companies that collect, aggregate, sell, resell, license or otherwise share consumer personal information with others. This is intended to cover those who collect information from consumers directly as well as those who only share previously collected information.[208] Since fintechs and online lenders often use data aggregation services, this RFI and its consequences could have impacts based on what the CFPB ultimately does. On September 19, 2024, the director of the CFPB in a speech indicated that the agency would be proposing a rule that would apply consumer protections of data to data brokers. While a rule was proposed in December 2024, it was withdrawn in May 2025.

***Negative Option Marketing Practices.*** In January 2023, the CFPB issued Circular 2023-01 dealing with unlawful negative option marketing practices. In short, negative option practices can violate the UDAAP provisions under the Consumer Financial Protection Act. Violations can occur if there is a

207 We also note that the CFPB updated its examination manual to add discrimination as an unfair, deceptive or abusive act or practice. The U.S. Chamber of Commerce and other trade groups filed a lawsuit against the CFPB, challenging this update as violating the Administrative Procedure Act. The district court sided with the trade groups and the case is on appeal to the Fifth Circuit, although the CFPB has eliminated that reference from its examination manual.

208 We note that in October 2022 the CFPB issued an advance notice of proposed rulemaking to implement Section 1033 of Dodd-Frank, which requires that consumers be given access to certain financial information and data aggregation services. No rule has been promulgated.

misrepresentation or failure to disclose the material terms of the negative option program, failure to obtain a consumer's informed consent or misleading a consumer who wants to cancel, creating unreasonable barriers to cancelation or failing to honor cancellation requests that comply with the disclosed cancellation procedures. The CFPB was concerned with marketing practices where silence or a failure to take affirmative action to reject a product or service exists or where there is a failure to cancel an agreement which is then deemed to constitute acceptance. The CFPB provides some examples such as automatic renewal programs that renew unless affirmatively cancelled, programs to receive products unless they cancel or the charging of a fee on a recurring basis unless there is an affirmative cancellation. The circular indicates that both the FTC and the CFPB have brought enforcement actions including for add-on products such as debt protection and identity theft protection. In order to avoid UDAAP violations, the guidance requires fulsome disclosure including of the material terms of any negative option offer and emphasizes the need to obtain informed consent before charging fees to a consumer and to provide for reasonable cancellation mechanisms that allow cancellation without undue interference.[209] Given the heightened scrutiny of negative option marketing practices, fintechs and online lenders engaging in such practices should review and follow the guidance carefully or risk enforcement proceedings. The circular was withdrawn in May 2025.

***Focus on Fair Lending.*** On May 6, 2022, the CFPB submitted its annual report on fair lending to Congress. Of note is the agency's prioritization of fair access to credit and also its notation that it will focus on emerging risks of digital redlining and algorithmic bias. The agency has been critical of both artificial intelligence and machine learning, and the report expressed a skepticism that technology can cure bias in credit underwiring and pricing. Credit models remain under review for potential discrimination.

On May 9, 2022, the CFPB issued an interpretive rule on the Equal Credit Opportunity Act (*"ECOA"*) and its implementing Regulation B, reminding the industry that the law and regulation not only apply to applications for credit but also continue after a loan has been made, including occasions of credit revocation or imposition of unfavorable terms that would necessitate the provision of a notice of adverse action. While this has been the position for some time of the CFPB and of other federal regulatory agencies, some federal district courts have found that the ECOA and Regulation B only apply to the credit application process.[210] The agency also noted that some creditors have challenged the

209 In October 2021, the FTC issued a policy statement applicable to non-bank entities on negative option marketing containing similar requirements on disclosure, informed consent and easy cancellation. In addition, some states (*e.g.,* California, Colorado, Delaware and Illinois) have enacted additional restrictions and requirements relative to negative option marketing.

210 This issue arises due to the definition of "applicant" in the law and regulation itself. But the banking agencies have determined that an applicant includes borrowers already granted credit. The Federal Reserve made this determination over forty years ago. An appeal in the Seventh Circuit, *Fralish v. Bank of America, N.A.*, Case Nos. 21-2846(L) and 21-2999, was dismissed in January 2022. An amicus brief was filed by the CFPB along with the Department of Justice, the Federal Reserve Board, and the Federal Trade Commission to the same effect as stated in the May 9, 2022, advisory opinion of the CFPB. However, in July 2024, the Seventh Circuit Court of Appeals ruled that ECOA and Regulation B apply to prospective applicants as well as applicants. *Consumer Fin. Prot. Bureau v. Townstone Mortg., Inc.,* Case No. 23-1654 (7th Cir. 2024).

applicability of the ECOA to events after credit application. Under the Rule, CFPB may look at all aspects of the credit relationship in applying fair lending laws.

***Insufficient Data Protection—UDAAP.*** On August 11, 2022, the CFPB published a circular stating that persons may violate the prohibition on unfair acts and practices contained in the Consumer Financial Protection Act if they have insufficient data protection or information security practices. The bureau highlighted three data security practices that could result in substantial injury to consumers without counterbalancing benefits and therefore trigger liability for financial institutions or their service providers. Those high-risk areas are inadequate authorization, poor password management, and lax software update policies. In addition to other issues related to electronic communications, this is yet another arena for marketplace lenders and Funding Banks to be aware of and comply with in order to avoid challenge as an unfair practice. This circular has not been rescinded.

***Enforcement Actions.*** In September 2022, the CFPB sued an online lender, alleging the fintech had overcharged military borrowers on its online loans and snared consumers into paid membership programs.[211] Consumers could not obtain loans unless they joined a membership program and paid monthly membership fees. The CFPB alleged that those fees push the cost of credit above the 36% rate cap on loans to military-related borrowers under the Military Lending Act. In addition, the use of an arbitration clause in the loan agreement also violated the law according to the CFPB. The CFPB also alleged that the fintech misled consumers regarding cancellation of their membership because their membership fees could not be cancelled so long as there was an unpaid balance on the loan. The suit seeks unspecified redress for consumers, injunctive relief and a civil money penalty. The agency filed an amended complaint asserting violations of the Consumer Financial Protection Act. The fintech filed a motion to dismiss the case, a portion of which were granted.[212] The defendant is asserting that deference should not be afforded to the CFPB based on the Supreme Court's overruling of the *Chevron* doctrine.

Another online lender issued a statement that it had received additional inquiries from the CFPB which is investigating its loan processing practices pursuant to an earlier civil investigative demand.[213] The company stated that it had disclosed several of the issues on its own and was offering restitution to customers dealing with processing issues. The prior CFPB investigated companies that had previous actions with the agency.[214]

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211 *Consumer Fin. Prot. Bureau v. MoneyLion Techs., Inc. et al.*, Case No. 1:22-cv-08308 (S.D.N.Y. filed Sept. 29, 2022).

212 In addition, MoneyLion argued that CFPB positions related to expiration of the statute of limitations have been mooted by another 2024 Supreme Court decision, which found that the statute runs from the time of injury rather than the time of promulgation of the rule.

213 Enova International, Inc. 10-Q filed Oct. 28, 2022.

214 Enova International, Inc. 8-K filed Jan. 25, 2019. Enova entered into a settlement in 2019 with the CFPB and paid a $3.2 million fine. Enova was also subject to an action and $15 million fine in 2023.

### *5. Non-Bank Registry for Violations and Contract Terms*

On December 12, 2022, the CFPB proposed a public listing of non-bank violators of consumer protection laws by regulatory agencies or courts. This "bad boy" list is intended to inform consumers of non-bank companies that have violated consumer protection laws and to require those companies to verify compliance on a periodic basis. It was also touted as a means to identify repeat offenders and direct enforcement and public action toward those companies. Among the intended targets identified by the CFPB were innovative financial products offered by non-bank fintechs. The proposal was widely criticized as public shaming and creating an unlevel playing field since there is no similar listing proposed for banks and other regulated financial institutions that were made exempt from the proposal. On June 3, 2024, the CFPB issued a final rule creating the registry. The final rule limits coverage to companies under CFPB jurisdiction and requires a senior executive to annually attest to any violations or noncompliance with registered orders. Those firms that file orders are likely to be subject to increased examination from the bureau and subject to increased penalties for violations. The rule became effective on September 16, 2024.

In January 2023, the CFPB issued a proposed rule that would create another registry of non-banks subject to CFPB supervision and identify contract terms used by those entities which waive or limit consumer rights or legal protections. Non-bank entities covered by the proposed rule would be payday lenders, private student lenders, mortgage lenders and servicers and large participants in credit reporting, debt collection and remittance transfers. Comments on the proposal were taken until March 2023. The CFPB indicated that several terms in form contracts, fine print or "take it or leave it" provisions would be included in the registry.[215] Critics of the proposal allege that the registry is a backdoor attempt to invalidate arbitration clauses and class action waivers because arbitration provisions would be a part of the registry.[216] The reporting requirement could act as a deterrent on the use of disfavored provisions, including arbitration, because reporting of disliked terms could be met with possible scrutiny or enforcement actions. While the CFPB has not yet finalized this rule, on June 4, 2024, the CFPB issued a circular warning consumers about the use of unlawful or unenforceable terms in consumer credit contracts.[217] The bureau indicated that certain contract terms may be unlawful or unenforceable and that consumers are not likely to understand this and may waive their rights unknowingly or unwittingly. The CFPB indicated that it would prohibit deception based on such terms that attempt to limit consumer protections sanctioned by law. The agency further indicated that a financial service provider could be held liable even if it were using form contracts used commonly in the industry. The CFPB also indicated that phrases such as "except where prohibited by law" could be

215 Examples given by the CFPB were waiver of servicemember legal protections, undermining credit reporting rights and limitation of liability for bank fees caused by repeated debit attempts.

216 The CFPB enacted a rule that would limit or prohibit the use of arbitration clauses in consumer finance agreements. The rule was struck down by Congress under the Congressional Review Act, which restricts the CFPB from enacting a substantially similar rule.

217 CFPB Circular 2024-03.

prosecuted as being deceptive. This broad-brush approach could expose businesses to additional risk and to actions by the CFPB. However, in May 2025, the CFPB announced its intent to rescind the rule and abandon the registry.

### *6. Examination of Non-Banks—CFPB Invokes Dormant Authority to Examine Non-Bank Companies*

In late April 2022, the CFPB announced that it was "invoking a largely unused legal provision to examine non-bank financial companies that pose risks to consumers."[218] This authority has not been used before. The announcement seems to target fintech companies, as the CFPB stated that this will allow it to supervise entities that are fast-growing or in markets outside the bureau's existing supervision programs. In essence, any non-bank not currently supervised will be subject to this unspecific and uncertain rule. Critics see this as a return to the mantra of "regulation by enforcement" rather than regulation, given the lack of guidelines the CFPB must follow in assessing risk to consumers or engaging in supervisory activity. While the bureau sees this as leveling the playing field with banks, it proposes to make its actions public, whereas this is not the case with much of the supervisory activities of depository institutions. At least in the short term, fintechs should expect closer scrutiny, examination and enforcement from the CFPB. On May 19, 2022, the CFPB announced that it would assist state enforcement of consumer protection law by working with and supporting state regulatory efforts to enforce the Consumer Financial Protection Act. In order to use this authority, the bureau must conclude that it has "reasonable cause" to believe that an entity is engaging in or has engaged in conduct that poses risk to consumers in connection with offering or providing a financial product or service.[219]

Since that time, the CFPB has been issuing notices to companies it thinks may be putting consumers at risk. Some of those companies have consented to the CFPB's supervision on a confidential basis. But in February 2024, the CFPB publicly announced its first risk-based supervisory order and asserted jurisdiction over World Acceptance Corporation in a contested proceeding.[220] As a result, the company, which is a large provider of small dollar loans, will become subject to the supervision of the CFPB. The order, while not alleging any violations of specific statutes, cited heightened risk due to the bundling of loans and insurance, collection practices, inaccurate credit reporting and high rates of refinancings. In part the CFPB based its determination on consumer complaints made in the agency's Consumer

218 CFPB Press Release, Apr. 25, 2022. Under the Dodd-Frank Act, the CFPB already had broad supervisory authority over all non-bank entities in the mortgage, private student loan and payday loan industries regardless of size and non-banks that are determined by regulation to be "larger participants" (currently including consumer reporting, debt collection, student loan servicing, international remittances and auto loan servicing).

219 Section 1024(a)(1)(C) of the Dodd-Frank Act. The CFPB also amended regulations as to the procedural aspects of invoking this authority. To initiate a proceeding the agency must issue a "Notice of Reasonable Cause."

220 *In the Matter of: World Acceptance Corp.,* CFPB File No. 2023-CFPB-SUP-0001. Available at: https://files.consumerfinance.gov/f/documents/cfpb_world-acceptance_decision-and-order_2023-11.pdf.

Complaint Database.[221] As a practical matter, the use of this authority allows the CFPB to either voluntarily accept its supervision or to become subject to public dissemination (and the potential of negative publicity) of an order subjecting the entity to supervision even if the basis of that order may not (as was the case with World Acceptance) be accused of any statutory wrongdoing. This authority can be used to strong-arm companies into accepting CFPB supervision. In August 2025, the CFPB issued a new proposed rule that would narrow the definition of risks to consumers, which would limit the scope of this supervisory authority.

### D. CFPB Jurisdiction over Securitization Vehicles

In 2017, the CFPB brought suit against 15 student loan trusts holding some $12 billion in private student loans.[222] After considering a motion to dismiss based on whether the CFPB could bring an action against a passive investment vehicle, a federal district court ruled in December 2021 that the CFPB could proceed against the trusts, determining that each of the trusts constituted a "covered person" under the Consumer Financial Protection Act and therefore was subject to the bureau's enforcement authority.[223]

> Special purpose entities are subject to CFPB enforcement actions and could become subject to liability even though they are only passive investment vehicles.

The CFPB alleged that to collect on defaulted student loans the trusts, through their servicers, used deceptive and unfair tactics, such as filing thousands of lawsuits with allegedly false supporting affidavits. The trusts argued that they do not qualify as "covered persons" under the law because they are just passive investment vehicles and don't themselves engage in debt collection or otherwise control what their servicers do. The judge disagreed, saying that the trusts couldn't disclaim involvement in a "key part of their business just because they contracted it out."

However, the judge recognized that this was a case of first impression, considering novel issues, and was significant and subject to room for reasonable disagreement. In February 2022, the judge granted a motion for an interlocutory appeal to the Third Circuit Court of Appeals, which the Third Circuit accepted and docketed on May 11, 2022.[224] Although oral argument occurred in March 2023, the Third Circuit did not issue a decision until March 2024. The Third Circuit affirmed the ruling of the district court and similarly found that the securitization trusts were covered persons engaged in the offering or

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221 The CFPB rejected arguments that unsubstantiated consumer complaints were not sufficient to make a reasonable cause determination. The agency also rejected defenses that the number of complaints was not appreciably larger than that of other lenders. Rather, the CFPB found the substance to be serious enough to meet the risk standard.

222 *Consumer Fin. Prot. Bureau v. Nat'l Collegiate Master Student Loan Tr.,* Case No. 1:17-cv-01323 (D. Del.), decision at 575 F. Supp. 3d 505 (D. Del 2021).

223 The court also found that the CFPB could bring the action despite the U.S. Supreme Court's ruling that the agency was not constitutionally structured.

224 *Consumer Fin. Prot. Bureau v. Nat'l Collegiate Master Student Loan Tr. et al.*, Case No. 22-1864 (3d Cir.).

provision of a consumer financial product or service. The trusts have filed a writ of certiorari with the United States Supreme Court requesting that the Supreme Court hear an appeal of the decision.

The case is of tremendous importance to the secondary and securitization markets. Now that the CFPB is allowed to bring actions directly against special purpose vehicles it could expose those passive investment entities to potential liability, which could lessen investor appetite for marketplace loans and create market volatility and uncertainty. In fact, after the Third Circuit decision, the CFPB brought an action against the trusts and the servicer requesting penalties and restitution of $5 million.[225] It is anticipated that while the CFPB may not become more aggressive in targeting securitization vehicles in the future, state attorneys general may.

### E. Federal Trade Commission (FTC)

In June 2016, the Federal Trade Commission (*"FTC"*) held a FinTech Forum addressing marketplace lending.[226] The forum focused on consumers and consumer protection. The FTC's Director of Consumer Protection, who has since left the agency, identified several areas that concern the FTC, including preauthorized transfers to repay loans, transparency of loan terms, privacy and data security, and potential discrimination arising from using nontraditional data to make credit decisions.

> The FTC has become another force in enforcing consumer protection laws with online lenders.

***Federal Trade Commission Actions.*** The Federal Trade Commission has broad authority to prevent unfair competition and unfair or deceptive acts and practices affecting commerce.[227] While the federal banking agencies supervise and regulate insured depository institutions, the FTC's enforcement posture focuses on non-bank entities. In the past, the FTC has prioritized fintech as an area of priority.

***Lawsuit Against Online Lender on Marketing Practices.*** On April 25, 2018, the FTC filed a complaint in federal court in California against a large marketplace lending platform.[228] The FTC claimed that the platform engaged in various deceptive practices including (1) telling customers that they would receive a loan with "no hidden fees," (2) telling customers that they were approved for loans when they were not, (3) that funds were withdrawn from customer bank accounts without authorization and (4) the required privacy notices were not provided to borrowers. The FTC further claimed that origination fees were charged without proper disclosure. The complaint sought injunctive relief and other relief,

225 *Consumer Fin. Prot. Bureau v. Pennsylvania Higher Educ. Assistance Agency et al.*, Case No. 1:24-cv-00756-JPW (M.D. Pa. filed May 6, 2024).

226 This was the first such forum. A second forum was held in October 2016 on crowdfunding and peer-to-peer payments and a third was held in March 2017 on blockchain technology and artificial intelligence.

227 Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

228 *Fed. Trade Comm'n v. LendingClub Corp.*, Case No. 3:18-cv-02454 (N.D. Cal. filed Apr. 25, 2018).

including rescission or reformation of contracts, restitution, refund of monies paid and disgorgement. The marketplace lender challenged all of the allegations and filed a motion to dismiss the proceeding, which was granted in part and denied in part. On October 22, 2018, the FTC filed an amended complaint to add further details concerning the alleged harm and providing additional examples of the platform's alleged misconduct. The platform filed an answer, portions of which the FTC moved to strike. Subsequently, some of the challenged practices have been stopped and the court urged the parties to settle the proceeding if appropriate consumer disclosures can be made.[229] In June 2020, the court addressed motions for summary judgment from each side.[230] In this case, the court in large part denied the summary judgment motions of the FTC, meaning that the case would go to trial on the "no hidden fees" claims. The judge ruled in favor of the FTC on the claim that loan approval communications to customers were misleading. However, in August 2020, the court stayed the proceeding until a case was decided by the United States Supreme Court dealing with whether the FTC has authority to order restitution for consumers harmed by conduct enforced by the FTC.[231] Since that issue was central to the remedy that the FTC is seeking, the California action was paused. This case was settled around the time the United States Supreme Court determined that the FTC did not have the authority to impose damages and restitution.[232]

The FTC has been focusing on the marketing practices of online lenders.

As stated above, the FTC settled litigation against a prominent lending platform in 2021.[233] In July 2021, the action was settled by the platform paying $18 million to the FTC for consumer redress, but neither admitting nor denying the allegations in the complaint. In addition, the platform was prohibited and enjoined from misrepresenting the amount of loan fees, the amount of loan proceeds, the status of any application, the timing of when consumers would receive their funds, or any other material fact concerning the loan. The platform also agreed to clearly and conspicuously state the dollar amount of any up-front fee whether financed or paid in cash and the total amount of funds to be disbursed to the consumer or on the consumer's behalf.

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229 The FTC action also precipitated a shareholder suit, *Veal v. LendingClub Corp. et al.*, Case No. 5:18-cv-02599 (N.D. Cal.). A motion to dismiss was filed by the platform, which was granted in November 2019 with leave to amend. A second amended complaint was filed and again the platform moved to dismiss, which was granted in June 2020, with leave to amend certain portions of the action. 2020 WL 3128909. The appeal of that decision was unsuccessful (Case No. 20-16603 Sept. 21, 2021, 9th Cir.).

230 A motion for summary judgment is a pleading asking the court to rule in favor of the moving party based on the pleadings and materials before the court, without additional proceedings or a trial. If a party is successful in a motion in its entirety, the case is resolved. Partial success on such motions serves to throw out certain allegations or causes of action and narrow the scope of the remaining proceeding.

231 On July 9, 2020, the U.S. Supreme Court agreed to hear two appeals on this issue. *FTC v. Credit Bureau Ctr.* (No. 19-825) and *AMG Capital Mgmt., LLC v. Fed. Trade Comm'n* (No. 19-508), Supreme Court decision at 593 U.S. ___, 141 S. Ct. 1341 (2021).

232 The majority of circuit courts allow the FTC to impose monetary damages and restitution; however, the Seventh Circuit issued a decision to the contrary, resulting in a split of authority. The Supreme Court decided the case, against the FTC.

233 *Fed. Trade Comm'n v. LendingClub Corp.,* Case No. 3:18-cv-02454 (N.D. Cal) (settlement filed July 14, 2021).

Non-bank marketplace participants subject to FTC jurisdiction should remain vigilant as to their compliance posture and practices.[234]

### *1. Federal Trade Commission—U.S. Supreme Court Ruling*

On April 14, 2023, the Supreme Court decided cases involving both the FTC and Securities Exchange Commission, finding that claims regarding constitutionality do not have to go through agency in-house administrative procedures prior to bringing a claim in federal court.[235] In essence, a litigant does not have to go through the administrative process they are challenging on constitutional grounds, such as the structure or existence of the agency itself. This may make it easier for litigants to challenge actions prior to a full-blown administrative proceeding being conducted.[236]

### *2. Supreme Court Limits FTC Ability to Order Consumer Restitution*

In April 2021, the United States Supreme Court ruled that the FTC does not have the authority to obtain equitable monetary relief such as restitution for consumer harm under Section 13 of the FTC Act.[237] While this ruling does not eliminate the FTC's ability to obtain damages for consumer harm, it makes it more difficult. Other provisions of the law allow for consumer redress, but they are also more complicated and impose additional legal requirements beyond what Section 13 required.[238]

Prior to this decision, the FTC used Section 13 for years to obtain monetary damages and it was deemed to be a well-established principle. However this section of the FTC Act allows only for injunctive relief and not for money damages. The Supreme Court agreed and found the Commission's use of Section 13 unlawful.[239] In the future, to obtain monetary relief, the FTC will need to navigate more cumbersome processes. For example, Section 19 may require the FTC to issue a final cease-and-desist order before seeking money damages. In addition, the proof required in order to obtain the requested damages is that a reasonable person would have known that the conduct was improper.

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234 Until May 2022 when a new FTC Commissioner was named to replace Rohit Chopra, who went to the CFPB, the FTC was deadlocked 2-2 politically and thus little action was taken during this interim period.

235 *Axon Enter., Inc. v. Fed. Trade Comm'n. et al.,* Case No. 21-86 (Apr. 14, 2023).

236 The corresponding decision as to the SEC is *Securities and Exch. Comm'n et al. v. Cochran*, Case No. 21-1239 (Apr. 14, 2023).

237 *AMG Capital Mgt., LLC v. Fed. Trade Comm'n*, 141 S. Ct. 1341 (2021). The FTC filed the action alleging deceptive payday lending practices in violation of Section 5 of the FTC Act. The district court granted an injunction and ordered $1.27 billion in restitution and disgorgement. The Ninth Circuit affirmed, rejecting the argument that Section 13(b) of the FTC Act does not authorize the award of equitable monetary relief. The Supreme Court reversed.

238 Legislation has been introduced in Congress that would give the FTC the authority to impose restitution under Section 13 of the FTC Act. To date it has not advanced.

239 The Supreme Court stated that Section 19's more difficult approach to receive monetary relief would not make sense if the legislature had intended Section 13 to allow monetary damages.

### *3. FTC Amends and Updates Safeguards Rule*

On October 27, 2021, the FTC issued a Final Rule clarifying and updating the Safeguards Rule promulgated under the Gramm-Leach-Bliley Act.[240] In addition to being applicable to depository institutions such as Funding Banks, the rule also applies to non-banks that are significantly engaged in providing products or services, covering most service providers and marketplace lending platforms. The rule requires these participants to develop and implement adequate security measures to keep customer data safe and mitigate the risk of cyberattacks or data security breaches. The clarifications in the new codification deal with how information security programs should be developed, requirements for employee training, and requiring risk assessment to be in writing. The update also provides guidance on increasing safeguards through the utilization of data encryption and authentication. One new change will require the designation of one key individual to be responsible for overseeing the information security program and also assuring internal compliance with the program. The final rule also requires periodic reporting to the governing body of the entity. This promulgation also extends coverage under the rule to include finders such as brokers or lead generators. Marketplace lending participants should be aware of these new changes and adapt policies, procedures, and operations to be in line with the changes.

***Student Loan Advertising.*** An online student lender settled charges brought by the FTC in connection with the agency's allegations that the marketplace lender was making false claims about the savings that would accrue in connection with a refinancing of the student loan.[241] The FTC claimed that advertising the lender used to solicit student loan refinancings was misleading because savings calculations were inflated or incorrect. The consent order entered into by the parties prohibits the platform from misrepresenting any savings from refinancings unless backed by proof. The FTC complaint stated that the claims of inflated savings began in April 2016 and appeared in television, print and Internet advertising. The FTC also alleged that when disclosures were made, they were buried in the fine print. In its public statement on the settlement, the FTC specified that it is putting other lenders making savings claims similar to those addressed in the proceeding on notice and is recommending that all advertising be reviewed to ensure that false or unsubstantiated statements are not being made.

***Loan Servicing Practices.*** In April 2019, an online lending company agreed to settle FTC claims that it had engaged in deceptive and unfair loan servicing practices.[242] The online lender paid a $3.85 million penalty. Allegations included that the platform imposed unauthorized charges on consumer accounts and had violated the Electronic Fund Transfer Act by requiring consumers to agree to recurring

240 The Safeguards Rule is codified at 16 C.F.R. pt. 314.

241 *In re Soc. Fin., Inc. and SOFI Lending Corp.*, Docket C-4673 (Fed. Trade Comm'n Feb. 25, 2019).

242 *Fed. Trade Comm'n v. Avant, LLC*, Case No. 1:19-cv-02517 (N.D. Ill. 2019).

automatic debits from their bank accounts as a condition of obtaining a loan.[243] In addition, the company told borrowers that it would accept debit or credit cards for payment when it in fact did not accept those types of payments. The platform allegedly withdrew payments from consumer accounts without authorization and in some cases took duplicate payments. Charges also encompassed failing to timely credit payments, providing inaccurate payoff quotes, and collecting additional amounts even after payoff. The FTC asserted that it views servicing just as important as loan marketing and origination and will hold online lenders accountable for their servicing practices.

***Electronic Fund Transfers.*** Regulators continue to focus on the practices of lenders when it comes to taking funds out of consumer accounts by electronic means. The Electronic Fund Transfer Act and Regulation E make it illegal to require payment of a loan by electronic means. The law and regulation also require consumer consent to withdraw funds from deposit accounts, and authorizations for recurring transfers require specific information and disclosures to consumers.[244] In May 2020, the FTC filed a Complaint against several related entities for various violations of federal law, including Regulation E.[245] Although this was a payday lender using a tribal business model, the Regulation E allegations included making withdrawals without having a proper customer authorization, making duplicate withdrawals for the same payment and making withdrawals without crediting the customer's account. The court entered a temporary restraining order and injunction against the companies, froze their assets and prohibited ongoing operations. Although other issues were involved in this action, it is clear that regulators are serious about enforcing Regulation E. Practices involving electronic transfers from customer deposit accounts should be reviewed routinely to ensure compliance.

### *4. Board of Governors of the Federal Reserve System (Federal Reserve)*

The Federal Reserve has conducted studies and issued reports that are supportive of marketplace lending.[246] In March 2018, the Federal Reserve Bank of Philadelphia published a research study using live lending data from LendingClub, titled "Do Fintech Lenders Penetrate Areas that are Underserved by Traditional Banks?"[247] The study concluded that fintech lending has expanded consumer access to credit, penetrated areas that have lost traditional bank branches, and allowed consumers to obtain credit at lower rates than through a bank-issued credit card. In addition, the paper found that the use

243 This is a violation of the law's implementing Regulation E, 12 C.F.R. pt. 205.10. A creditor may offer an incentive in order for a borrower to agree to payment by recurring electronic transfers. Certain notifications and requirements apply to pre-authorized transfers under the law and regulation.

244 12 C.F.R. pt. 1005.10.

245 *Fed. Trade Comm'n v. Lead Express, Inc. et al.,* Case No. 2:20-cv-00840-JAD-NJK (D. Nev. filed May 11, 2020).

246 We note, however, that in November 2017 the Federal Reserve Bank of Cleveland published a study of peer-to-peer lending that claimed the perceived benefits of that type of lending were overrated and that it resembled predatory lending. The study was widely discredited as having used flawed methodology and within days of its posting, the Reserve Bank removed the study from its website.

247 Jagtiani, Julapa, and Lemieux, Catharine, *"Do FinTech Lenders Penetrate Areas that are Underserved by Traditional Banks?"* Fed. Reserve Bank of Philadelphia (May 15, 2018; revised June 18, 2022).

of alternative credit data has enhanced financial inclusion. The study indicated that these borrowers were on average more risky than traditional borrowers with similar characteristics, such as FICO scores, and that online lenders were providing additional access to credit based on the use of alternative underwriting standards and data.

A staff report issued in February 2018 by the Federal Reserve Bank of New York concluded that the technological innovations implemented by fintech mortgage lenders have been beneficial to consumers and have improved the efficiency of the mortgage lending market.[248] This study looked at mortgage lending in particular, finding that fintech mortgage lenders provided more timely processing and quicker responses to fluctuations in demand as compared to traditional mortgage lenders. The study found that online lenders reduced mortgage processing time by 20% and online loans experienced lower levels of overall delinquency.

***Federal Reserve Study: Online Small Business Lending.*** On June 28, 2018, the Federal Reserve Board and the Federal Reserve Bank of Cleveland released a report concerning online small business lending.[249] The study encompassed only small businesses with fewer than 20 employees and less than $2 million in annual revenue that had shopped for credit in the last year. The study found that small business owners preferred traditional lenders to online lenders, although they expressed frustration concerning loan approval and underwriting processes and the requirements of those traditional lenders. When considering online lenders, the small businesses preferred platforms that provided more information about their products and pricing prior to beginning the application process. Small businesses found additional and repeated marketing by online lenders to be annoying. On balance, the report showed that more robust disclosure was preferred, particularly related to pricing. Similarly, small business owners were concerned with the lack of full information or the use of undefined terms. The survey respondents were also presented with sample disclosures. Small business owners were overwhelmingly desirous of receiving additional information (similar to what consumers receive on consumer loans) such as loan amount, repayment amount, term, and APR.

***Fintech Risk Management Guidance.*** The Federal Reserve published guidelines for banks engaging in innovation.[250] The guidance focuses on risk management and stresses that banks identify and mitigate risks before entering into fintech relationships. This involves board and senior management oversight, policies and procedures, training, monitoring, and oversight. It also emphasizes vendor management and fair lending compliance for online and Internet-based programs, as well as monitoring complaints.

248 Fuster, Andreas; Plosser, Matthew; Schnabl, Philipp; and Vickery, James, "The Role of Technology in Mortgage Lending," Fed. Reserve Bank of New York Staff Report No. 836, Feb. 2018.

249 "Browsing to Borrow: 'Mom & Pop' Small Business Perspectives on Online Lenders," available at https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf.

250 Published in the December 2019 issue of the Consumer Compliance Supervision Bulletin. The Federal Reserve and the other federal banking regulators issued guidance in June 2023 on third-party relationships and risk management.

*Small-Dollar Loans.* The Federal Reserve along with all of the other federal banking agencies issued an "Interagency Lending Principles for Offering Small-Dollar Loans" in May 2020. This promulgation encouraged financial institutions to offer responsible small-dollar loans to consumers and small business owners. It stated core lending principles and that products offered through effectively managed third-party relationships should reflect core lending principles including returns reasonably related to the institution's risks and costs.

However, a Federal Reserve study indicated that small-dollar loans require high interest rates in order to break even.[251] For example, a $600 loan needs a 103.5% APR to break even while a loan of near $1,200 needs an APR of about 61%. The study found that with substantial fixed costs, high interest rates are necessary to provide sufficient revenues to cover the costs of providing such loans. The study also stated that if small loan revenue is constrained by rate ceilings, institutions would only provide large loans, and consumers who need a small loan would not be served by the interest rate ceiling.

### *5. Federal Reserve Publication on Bank-Fintech Partnership*

On September 9, 2021, the Federal Reserve Board published a guide on relationships between community banks and fintech companies.[252] The paper discussed three types of partnerships that community banks might use to leverage the benefits of fintechs. These include operational technology partnerships that enhance the bank's infrastructure or processes; customer-oriented partnerships such as assistance with account opening, where the bank retains customer contact; and front-end partnerships where the fintech interacts with the bank customer. The Federal Reserve notes that for a relationship to be successful strategically and operationally, the bank must have an ongoing commitment to innovation, congruent priorities with the fintech, and integrated connections between the two parties. This public dissemination is another example of federal banking regulators paying attention to bank-fintech relationships.

### *6. Interagency Guidance on Risk Management in Third-Party Relationships*

In July 2021, the Federal Reserve, the OCC and the FDIC proposed interagency guidance for banks dealing with managing risk related to third-party relationships. This guidance includes bank arrangements with fintechs, including bank/fintech programs. While each agency has risk guidelines, this was the first instance where all three agencies worked together to propose this on an interagency basis. The guidance derives from the OCC's existing guidance from 2013 and makes changes to encompass the other banks supervised by the other agencies.[253]

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251 Chen, Lisa, and Elliehausen, Gregory, "The Cost Structure of Consumer Finance Companies and Its Implications for Interest Rates: Evidence from the Federal Reserve Board's 2015 Survey of Finance Companies," FEDS Notes, Washington: Board of Governors of the Federal Reserve System, Aug. 3, 2020, https://doi.org/10.17016/2380-7172.2610.

252 "Community Bank Access to Innovation through Partnerships" (Sept. 2021).

253 In March 2020, the OCC supplemented its 2013 guidance with a set of revised FAQs to update and clarify it to take into account industry evolution.

Building on existing promulgations including vendor management guidance, the proposal deals with managing risk at each juncture of a third-party arrangement, including (1) planning, (2) due diligence and selection, (3) contract terms and negotiation, (4) oversight and monitoring, and (5) termination. Each area is general and does not discuss specific types of relationships. Both existing guidance and this proposal reiterate the importance of banks paying attention to third-party relationships and managing risk appropriately. In June 2023, the OCC, the FDIC and the Federal Reserve issued guidance on third-party relationships and risk management that superseded prior issuances. The guidance still requires financial institutions to manage risk throughout the third-party relationship.

*Interagency Guidance on Security Incidents.* It should also be noted that on November 23, 2021, the FDIC, the OCC and the Federal Reserve issued a joint final rule that established computer security incident notification requirements for banking organizations and their bank service providers effective May 1, 2022. While banking institutions such as Funding Banks must report security incidents directly to the FDIC, service providers to the institutions must notify the affected bank as soon as possible when the service provider determines that there has been an incident that has materially disrupted or degraded or is reasonably likely to materially disrupt or degrade services provided to the banking organization for four or more hours. Therefore, the servicers to Funding Banks must comply with this rule.

### F. U.S. Congress Fintech Hearing

On January 30, 2018, the Financial Institutions and Consumer Credit Subcommittee of the United States House of Representatives held a hearing entitled "Examining Opportunities and Challenges in the Financial Technology ('FinTech') Marketplace."[254] Five witnesses submitted written testimony and responded to questions asked by members of Congress. Industry as well as consumer proponents participated in the proceeding. While some questions were raised, there was positive commentary on fintech and bank partnerships as well as the benefits of innovation and the work being done to enhance consumer protection and regulatory compliance. Congress also has a Task Force on Financial Technology and conducts hearings periodically on issues such as a November 2021 hearing on "buy now pay later" products.

### G. Basel Committee on Banking Supervision

On February 19, 2018, the Basel Committee on Banking Supervision released a report entitled "Sound Practices: Implications of fintech developments for banks and bank supervisors."[255] This report focused on how technology-driven innovation may affect the banking industry as well as the activities of banking supervisors. The study suggests that banks will find it increasingly difficult to maintain their current operating models given technological change and customer expectations and will undertake

254 Committee Memorandum available at https://financialservices.house.gov/uploadedfiles/013018_fi_memo.pdf/.

255 The report is available at https://www.bis.org/bcbs/publ/d431.pdf/.

more third-party relationships and outsourcing to unaffiliated service providers. In addition, fintech has the potential to lower barriers of entry to financial services, and elevating the role of data will drive the emergence of new business models, presenting both opportunities and risks for banks and the banking system. Likely issues cited in the report include safeguarding data, privacy, cybersecurity, consumer protection, competition and AML compliance. As traditional banking business models change, the report concludes that bank supervisors will need to improve supervisory efficiency and effectiveness, including through the use of technology. The report also stresses the need for bank supervisors to promote interaction with each other and with innovative financial participants.

### H. General Accounting Office

On March 22, 2018, the Government Accountability Office (*"GAO"*) issued a report titled "Financial Technology: Additional Steps by Regulators Could Better Protect Consumers and Aid Regulatory Oversight."[256] The report states that fintech provides benefits to consumers and poses similar risks to traditional products. It further states that while the extent to which fintech is subject to federal oversight varies, consumer harm appears to be limited. The GAO acknowledges that the U.S. regulatory structure poses challenges to fintech firms and that such firms have expressed that it can be difficult for them to identify the applicable laws and ascertain how their activities will be regulated. The report also emphasizes that complying with fragmented state requirements is costly and time consuming. The report recommends that federal regulators engage in more collaboration and coordination, develop offices of innovation (to the extent they have not already done so) and engage in knowledge building initiatives including consideration of what is being done in other countries such as regulatory sandboxes. These recommendations are consistent with the GAO's framework calling for regulatory systems to be flexible and forward-looking, which will help regulators adapt to market innovations.

In December 2018, the General Accounting Office published a report on the use of alternative data by fintech lenders in order to determine creditworthiness of borrowers. The GAO indicated that while there are potential benefits of using such data—such as greater access to credit—risks also exist from that use, including the potential for fair lending issues such as disparate impact. While the CFPB and other federal financial regulators have monitored the use of alternative data by fintech companies, the agencies have not provided specific guidance on how such data can be utilized in the underwriting process. The GAO recognized the bank partner model and indicated in the report that clarification of this issue would help those banks manage their relationships with marketplace lenders. The GAO recommended that the federal agencies provide guidance on the appropriate use of alternative data in the underwriting process both to marketplace lenders and Funding Banks.

256 GAO-18-254 (Mar. 22, 2018). The 132-page report was issued as a "Response to Congressional Requestors" and addresses fintech payment, lending, wealth management and other products. Many of the report's recommendations deal with the issue of account aggregation data.

In January 2019, the GAO published a report on federal oversight of Internet privacy. In part, this study was conducted after several incidents of misuse of consumer personal information derived from the Internet. The GAO recommended that Congress develop comprehensive legislation to deal with Internet privacy with the stated objective of enhancing consumer protections and providing flexibility to address changes in a rapidly evolving space.

In March 2019, the GAO publicly released a report on consumer data protection.[257] The GAO noted there were several FTC and CFPB enforcement actions and called for action by the federal agencies to strengthen oversight of consumer data and consumer reporting agencies. The report recommends that the FTC be given civil penalty authority to enforce the safeguarding of personal information and urged the CFPB to prioritize examinations to address data security at reporting agencies.

In March 2023, the GAO released a report on "Fintech Technology: Products Have Benefits and Risks to Underserved Consumers, and Regulatory Clarity Is Needed."[258] As the title imparts, the paper noted that products have benefits to those who do not use traditional banking services, but also carry risks of not having fees disclosed or making sure the product is understood by the consumer. Credit-builder products and small-dollar loans were reviewed along with certain deposit-type products and EWA products. As a result, the need for regulatory clarifications for new and innovative products was emphasized.

### I. Small Business Administration

On May 12, 2023, a Final Rule will go into effect for certain SBA loans and lenders. The SBA is eliminating its forty-year-old policy limiting the number of nondepository institutions that may participate in its loan guarantee programs under Section 7(a) of the SBA Act. It is a move designed to allow more fintech lenders into SBA lending in order to provide more capital to small businesses, particularly underserved borrowers. The Section 7(a) loans come with an SBA guarantee up to 85% of the loan. Banks and credit unions, the largest SBA lenders, were critical of the rule on the basis that fintechs were responsible for some of the fraud incurred in the PPP (Payment Protection Plan) loan programs during the pandemic. The SBA has indicated that it can monitor the additional nondepository lenders in an adequate manner.

### J. COVID-19

As is true of other areas of the economy and life in general, marketplace lending was affected by the pandemic in many respects. From a legal and regulatory perspective, however, the changes were few.

257 GAO-19-469T (pub. Mar. 26, 2019).

258 GAO-23-105536 (Mar. 2023). Later in 2023 the GAO issued GAO-23-106168 (Sept. 2023), titled: "Financial Technology: Agencies Can Better Support Workforce Expertise and Measure the Performance of Innovation Offices," recommending that the federal banking agencies provide training and resources to their personnel to deal with fintech innovation and relationships.

H.R. 748, better known as the CARES Act or more informally as the $2 trillion stimulus bill signed by President Trump on March 27, 2020, contained one important provision for all consumer lenders, including those making or servicing marketplace loans. With the expectation that economic activity would be decreasing and unemployment would be increasing, it was anticipated that loan payments may not be made or that borrowers would ask for relief from their payment obligations. A part of the legislation deals with this issue as it relates to credit reporting.

*Credit Reporting.* Section 4021 of the CARES Act revises Section 623(a)(1) of the Fair Credit Reporting Act (15 U.S.C. 1681s-2(a)(1)) and affects any consumer lender or servicer who furnishes credit reporting information due to an accommodation for hardships resulting from the COVID-19 virus. Accommodation is defined very broadly to include any deferral of payments, partial payments, forbearances, or any modification of a consumer loan.

Since federal banking agencies recommended that financial institutions work with borrowers during the time of national emergency, this law was particularly important as lenders try to assist borrowers. The new provision applies from January 31, 2020, until the later of 120 days after March 27 or 120 days after the date the national emergency is terminated, which was May 11, 2023.

When an accommodation is made and the borrower makes payments or is not required to make payments, the creditor must report the loan obligation as current. If the loan was delinquent before the accommodation period began, the creditor can continue to report the obligation as delinquent. On the other hand, if the borrower brings the account current, the creditor must report the obligation as current. The exception is a charge-off, which may continue to be reported as a charge-off.

Creditors and servicers reporting credit information need to follow the new requirements when a loan modification or accommodation is made. However, it is left up to creditors to determine if and what kind of an accommodation is made, if any.

*Payment Protection Program (PPP).* A primary provision of the CARES Act was the PPP for small businesses. Small businesses were eligible to apply for loans which, if certain conditions were met, would be forgiven. The program reached over 5 million small businesses for loans totaling over $525 billion. While the requirements of the PPP program affect all lenders the same, the significance for the marketplace lending industry was that several marketplace lenders either made PPP loans or worked with banks to assist in the making of PPP loans.

## II. MARKETPLACE LENDING AND THE 2023 BANK FAILURES

Toward the end of April 2023, the failure of three banks was of great interest to the fintech world. In March 2023 Silvergate Bank, a niche institution serving the cryptocurrency market, shut its doors amid continuing problems of crypto businesses that were its primary customers. Soon thereafter, the FDIC placed Silicon Valley Bank into receivership and then Signature Bank, both banks with significant

connections and customers in the fintech industry.[259] When depositors withdrew more funds than liquidity could handle, the institutions failed. Other banks also rescued another bank in the fintech space.[260] The failures created a great deal of concern related to deposits, loans, security and other related issues.

> Bank failures in 2023 underscore the need for contingency planning for both fintechs and Funding Banks.

We deal with only some of the legal and regulatory aspects of a bank failure. When a bank fails, the FDIC is appointed receiver and either is charged with selling the assets and finding a place for the deposits to be assumed, or engages in liquidation of the bank. The FDIC is given "super powers" to resolve these troubled situations, including the ability to void contracts of the failed institution, which creates uncertainty in the short term. There is also possible delay involved in getting access to deposits, draws on loans or foreclosing on collateral held at the distressed institution. One of the looming issues in the recent failures was the large amount of uninsured deposits being held at each institution. The FDIC only insures each depositor for up to $250,000 for specified categories of accounts. Where operating accounts, servicing collection accounts or collateral accounts are held at a bank, amounts above the deposit insurance maximum are uninsured and subject to possible loss if the institution's assets cannot cover depositor liabilities.[261] In the case of one bank failure, the FDIC utilized the uncommon structure of placing assets and liabilities in a bridge bank and due to the large size of the institution provided insurance coverage to all uninsured deposits transferred to the bridge bank. As is the case in most bank failures, the FDIC places the assets and liabilities of the failed institution with a healthy institution.

However, these events raise the question of the potential impact of bank failures on fintech and conversely the effects of failures of fintechs on Funding Banks.

### A. Issues for Fintechs and Their Funding Bank

For fintechs, a primary question is the insurability of their deposits. Many Funding Banks require collateral accounts in conjunction with the loan programs associated with a fintech. If those deposits are in one account, they will only be insured up to $250,000 by the FDIC, and excess amounts could be at risk in the event of the bank's failure. Additional insurance could be possible through opening an account in a different insurable category (such as a trust account) that would allow for additional

259 There is plenty of finger pointing as to what went wrong at these institutions: mismatch of assets and liabilities due to investment in long-term Treasury bonds, mismanagement, an unhealthy percentage of uninsured deposits, failure of regulatory oversight and being too heavily concentrated in fintech, to name a few possible causes. We do not address these matters but provide an overview of some of the legal issues resulting from bank failures.

260 A consortium of large banks invested in First Republic Bank. The Federal Reserve also set up a fund that banks could draw on. Some of the effects were worldwide with the failure of Credit Suisse, which was taken over by UBS.

261 Our website offers additional information about bank failures and their aftermath at www.chapman.com.

coverage, having accounts held by different corporate entities or requiring the bank to arrange excess amounts to be placed in another institution to provide additional insurance coverage.

Fintechs should also become more diligent in their ongoing review and monitoring of the bank, similar to the way the Funding Bank monitors the financial condition of the fintech. This may include greater diligence at the outset of a program to assess the bank's risk and compliance structure and its history and relationship with its regulators. In addition, while some of these situations occur rapidly, others develop over time and the fintech should explore representations of the Funding Bank as to financial condition, such as adverse changes in condition, maintaining an adequate level of capitalization or liquidity, and related notification of any breach of those conditions and the ability to invoke remedies if the breach is not cured.

Since the regulators of the Funding Banks may scrutinize program relationships based on the recent dislocation related to fintechs, fintechs need to be in a position to respond to the institution and to be sure that its policies, procedures and compliance structure are not only up to date, but are working well. Some fintechs offer their customers deposit capabilities at a bank typically through an umbrella account at the bank for the benefit of (FBO) the fintech customers.[262] In situations where deposit insurance is being provided to those customers, the fintech is usually responsible for keeping the records of the beneficiaries of the account that would allow the FDIC to determine how much insurance coverage would accrue to each customer. Fintechs in this role should be sure that their records comply with applicable FDIC requirements so that customers receive the benefit of any promised FDIC insurance.[263]

Fintechs should also provide with a Funding Bank an exit strategy in the event of regulatory problems or a bank failure. While this may have a potential impact on any contractual agreements with a Funding Bank as to the exclusivity of the relationship, there also needs to be a plan in place for movement or transition of the program in the event of a receivership or if the FDIC voids the contract for the program. This may include having in place a backup or multiple Funding Banks.

Fintechs should be prepared to deal with financial instability or failure of their Funding Bank.

### B. Funding Bank Issues for Fintech Distress

Also in recent times there have been reports of layoffs at fintechs, even large and well-known fintechs, and in times of higher interest rates and a slower economy additional pressure is placed on marketplace

262 The current situation has also called into question sweep arrangements. If accounts are subject to a sweep arrangement, FDIC insurance may only cover the amounts when at the bank. If the amounts are swept into non-bank or securities accounts, FDIC insurance may not be applicable. These should also be reviewed in light of what disclosures are being made to depositors.

263 As earlier discussed in this section, the FDIC is concerned that statements about deposit insurance are correct and do not mislead consumers. Disclosures concerning insurance should be reviewed since the FDIC is likely to review and examine these statements. The FDIC has proposed rules as to FBO accounts, particularly that the bank have access at all times to information about consumer accounts.

programs and pullback of investor appetite for these types of assets. As a result, Funding Banks also need to prepare for situations where the bank's service provider is subject to adverse financial conditions, becomes insolvent, or declares bankruptcy. The Comptroller of the Currency has publicly stated that the OCC expects Funding Banks to have robust contingency plans in place in the event of fintech failure. This means that Funding Banks need to make sure that they have contingency plans in place to provide for these types of events and to minimize the risk associated with potential impacts on customers and the reputation of the institution.

As part of a bank's vendor management and onboarding process, there should be appropriate diligence of the financial condition and prospects of the fintech. The program agreement should address appropriate financial covenants, collateral security, and reporting and notification obligations. If the fintech has relationships with other service providers including processors, there should be planning and consideration given to the ability to assume important servicing contracts or relationships while protecting the bank from the liability of obligations incurred by the fintech. The bank should also have access to the fintech's systems and be able to view and review customer accounts and, if necessary, have the ability to step into the shoes of the fintech if needed.

Ongoing communication with the fintech and monitoring of the program are crucial. While these require additional effort and cost, the Funding Bank needs to be able to assume, wind down or transfer program responsibilities and assure its regulators that it can be nimble and quick in protecting the bank and program customers.

## III. LENDING LAWS, LICENSING, AND RELATED LITIGATION

The extension of consumer credit in the United States is heavily regulated at both the federal and state levels.[264] A marketplace lender that conducts a nationwide business therefore may be subject to regulation under various laws and, potentially, by multiple jurisdictions. Generally, an Internet-based

264 The extension of commercial credit, while less regulated than consumer credit, is still subject to some federal and state laws including usury limitations and licensing requirements in some states, most notably in California, and in New York for loans less than $50,000 to sole proprietors. Several other states also have licensing requirements that might be applicable to some forms of business lending. As described herein, several states have enacted and other states are considering disclosure laws applicable to consumer lending. These laws place put in place consumer-type disclosures to business loans. Business lenders also rely on choice-of-law provisions in their loan agreements. Such provisions are generally enforceable in commercial transactions so long as the state whose laws are stated to apply has a reasonable relationship to the transaction. Governing law provisions may not supersede licensing and usury laws in some states. Also, some state laws limit how business borrowers can complain about alleged usury violations. For example, in some states corporate entities may not plead usury as a defense. *See, e.g., Klein v. OnDeck Capital, Inc.,* No. 62996-2014 (S. Ct. N.Y. 2015). OnDeck, an online business marketplace lender, made a business loan at an interest rate of almost 37% to a New York corporate borrower based on the law of Virginia, where OnDeck is located. The court upheld OnDeck's position that Virginia and not New York law governed the agreement and that the loan was not usurious under the law of Virginia. The court also stated that even if New York law applied, corporations only have a defense to payment based on usury and cannot bring an action for usury offensively. The borrower alleged that the loan was for consumer purposes, but the court found otherwise based on the loan documents stating that the loan was for business purposes. States are also enacting statutes requiring disclosure to be made on some commercial loans and related financing products, notably California and New York but other states as well.

consumer lending program will utilize a Funding Bank because a lender who makes loans directly and does not use a Funding Bank will need to obtain applicable state lending licenses. The Funding Bank will be subject to both federal and state regulation as well, but may in certain instances be able to rely upon federal law to preempt state laws that would otherwise apply. As discussed further below, federal preemption is particularly important to the Funding Bank in connection with state usury laws.[265] Lenders who facilitate loans made through Funding Banks will often purchase each loan from the Funding Bank at the time or soon after the loan is made.[266]

Non-bank lenders making loans directly to borrowers will not be subject to direct supervision by federal banking or financial institution prudential regulators such as the FDIC, the OCC or the Federal Reserve Board.[267] However, they may be subject to state licensing and regulation as well as oversight and regulation by the FTC and/or the CFPB. Each Funding Bank involved in an Internet lending program will remain obligated to comply with applicable laws in originating and funding the Borrower Loans. Marketplace lenders working with Funding Banks are also subject to supervision and oversight by the Funding Bank's regulators.[268]

> **Worth Remembering:** Due to the amount of attention that marketplace lending is receiving from state regulators, federal banking agencies and continued litigation challenging the structure whereby a Funding Bank is used, the use of Funding Banks creates some degree of uncertainty and potential regulatory and litigation risk and requires that particular attention be paid to the structuring of the program.

A full discussion of the financial institution regulations that will affect Internet lending businesses and the extent to which specific regulations will apply to specific persons is beyond the scope of this book. In this Part II, we briefly discuss some of the main banking or lending regulations, state licensing requirements, and consumer protection laws that may apply to the marketplace lender and/or the Funding Bank as well as relevant litigation in this space.[269]

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265 It cannot be assumed that federal laws governing consumer lending activities will preempt all state laws that impose additional or different requirements. The analysis of the application of the federal preemption doctrine to any particular market participant, transaction, or contract must be fact-specific and careful attention must be paid to the identities of the parties involved, the terms of the applicable statutes, and any relevant regulatory or judicial interpretations.

266 Other purchase arrangements can also occur. Sometimes loans may be sold to investors or into trusts, for example. Loan participation structures may also be used where the Funding Bank retains title to the loan but sells economic interests in the loans to investors or the program sponsor.

267 We note that there is a difference between being subject to direct supervision and examination by regulatory authorities and the need to comply with the applicable regulations of those authorities.

268 Marketplace lenders that provide services to banks may be subject to examination and regulation by federal banking regulators under the Bank Service Company Act (12 U.S.C. § 1867(c)).

269 This book is not intended to (and does not) identify all such laws and regulations that will be applicable to the lender and/or the Funding Bank in connection with their operations nor does it discuss all of the obligations that will be imposed by those

### A. Usury Laws

Most states limit by statute the maximum rate of interest that lenders may charge on consumer loans.[270] The maximum permitted interest rate can vary substantially between states.[271] Some states impose a fixed maximum rate of interest while others link the maximum rate to a floating rate index. Absent an exemption, these laws would be binding on the lender making the Borrower Loans (whether making loans directly under a state license or utilizing a Funding Bank) and would have to be observed in setting the interest rate for each loan. Given the nature of an Internet platform, it could be difficult for a marketplace lender conducting business in multiple states to set different maximum rates for the Borrower Loans based on the borrower's state of residence. Doing so would prevent the lender from conducting its business on a uniform basis across jurisdictions. State laws may also prohibit or limit the amount of fees that can be charged to consumers for delinquency or returned payments, presenting another compliance burden for lenders who conduct a multistate business. Violations of usury laws can result in various penalties from state to state, including voiding the entire loan in some states.[272]

In addition, the lender may want the ability to set interest rates that exceed the maximum rate that the applicable state usury laws would permit. One of the stated goals of Internet-based lending is to provide broader access to credit to certain borrowers who are unable to obtain bank loans. Although the lender may require each borrower to have a specified minimum credit score (and may set the minimum score at a relatively high level), many of these borrowers—despite having acceptable credit scores—may have other attributes indicating that they are less creditworthy than their credit scores, considered alone,

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laws and regulations that are identified. Prospective marketplace lenders are advised to consult with counsel for a more complete statement of the applicable requirements.

270 State usury laws also may limit or restrict other loan terms and the duration of loans. Usury is a complicated subject and can be affected by the type of entity making the loan, the type of loan or borrower, or the amount of the loan.

271 The application of state usury laws to commercial loans also varies from state to state but, as a general matter, state usury laws have less application to commercial loans than to consumer loans, as commercial rates are often deregulated. Lenders may also use choice-of-law provisions in a commercial lending context, particularly in states where no licensing requirements exist as the basis for usury purposes. Choice of law is often given effect in a commercial lending context where the jurisdiction has a reasonable relationship to the parties or the transaction. Some states also restrict the ability of business entities to utilize usury as a defense.

272 For consumer loans, it should be noted that a governing law provision may not be upheld with respect to questions of usury. For example, a consumer loan agreement specifying that the loan will be governed by the laws of State X for a loan made to a consumer in another state will not generally allow the usury laws of State X to supersede the usury laws of the borrower's state. State regulators take the position that consumer loans made over the Internet to residents in their state must follow the usury and licensing requirements of that state. In Minnesota, a court decision upheld an $8 million judgment against an online lender located in Delaware making loans to Minnesota residents over the Internet using a Delaware choice-of-law provision. The court found that the lender had to comply with both Minnesota licensing laws and its interest rate restrictions. *See State ex rel. Swanson v. Integrity Advance, LLC,* 846 N.W.2d 435, 444 (Minn. Ct. App. 2014), *aff'd sub nom. Swanson v. Integrity Advance, LLC*, 870 N.W.2d 90 (Minn. 2015).

would suggest. In order to make loans to these individuals, the lender will need to set interest rates high enough to offset expected losses.[273]

A potential solution to these difficulties is provided by the so-called "rate exportation rules" that may be utilized by FDIC-insured financial institutions. These are a set of federal laws, interpretative letters, and court decisions that remove most state usury law restrictions for the benefit of certain categories of lenders. The Depository Institutions Deregulation and Monetary Control Act of 1980 (*"DIDA"*) permits federally insured state-chartered banks to charge loan interest at rates not exceeding the higher of (i) the maximum rate allowed by the state in which the loan is made, and (ii) the maximum rate allowed by the bank's home state.[274] For example, in many programs the Funding Bank is an FDIC-insured, Utah-chartered bank or industrial bank. Utah law does not currently limit the interest rates that lenders may charge on loans that are subject to a written agreement. As a result, boards rely on DIDA to fund Borrower Loans at interest rates that are not limited by the state usury laws of other states.[275] It should be noted, however, that DIDA permits a state to opt out of the federal rate exportation rules insofar as such rules apply for the benefit of state-chartered institutions.[276]

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273 A 2020 study by the Federal Reserve found that the break-even point for small-dollar loans resulted in high annual percentage rates (APR). See the "Recent Developments in Marketplace Lending Regulation" section.

274 National banks rely on 12 U.S.C. § 85 in order to export the interest rate allowed by the laws of the state, territory, or district where such bank is located. Until the passage of the Dodd-Frank Act, an operating subsidiary of a national bank could also utilize rate exportation in reliance on OCC Chief Counsel interpretative opinions. However, those subsidiaries may no longer take advantage of such federal preemption of state law. The corresponding provision applicable to state banks is Section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d. The provisions are nearly identical. The United States Supreme Court has upheld the rate exportation theory in a case involving a national bank. *See, Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.,* 439 U.S. 299 (1978). *Accord,* as to state banks, *Greenwood Tr. Co. v. Massachusetts,* 971 F.2d 818 (1st Cir. 1992), *cert. denied,* 506 U.S. 1052 (1993). Codified for national banks at 12 C.F.R. pt. 7.4001(a) and for state banks in FDIC General Counsel Opinion No. 10.

275 Prospective marketplace lenders evaluating potential Funding Banks should be aware of the potential application of the so-called "most favored lender" doctrine. This doctrine, if applicable, permits a depository institution to fix as its interest rate ceiling for any category of loans the highest interest rate that the relevant state permits to any lender for such category. As an example, if a particular state permits finance companies to make consumer loans at a higher interest rate than it permits to banks, a national or state bank making loans in that state could rely upon the most favored lender doctrine to make loans at the higher rate permitted to finance companies. The so-called state "parity" laws also may be of use in Internet lending. These laws, where available and in relevant part, may permit banks chartered in a particular state to extend credit in that state on the same terms as are permitted to national banks. The most favored lender doctrine and the state parity laws, when applied in conjunction with the rate exportation rules, may permit Funding Banks to fix the interest rates for Borrower Loans at rates significantly higher than the usury laws would otherwise permit. In any case, reliance on the most favored lender doctrine and state parity laws should not be necessary where the Funding Bank is FDIC-insured and located in a state that does not cap the interest rate that banks may charge on consumer loans.

276 Loans made by state-chartered institutions in states that opt out of the federal rate exportation rules will remain subject to that state's usury laws. At this time, only Iowa and Puerto Rico have opted out of the federal rate exportation rules for state-chartered depositories. Colorado enacted legislation to opt out but it is being challenged in court and the enactment is currently stayed. Other states are considering legislation to opt out. An election by any state to opt out under DIDA will be effective as to loans "made" in that state, although it may not be entirely clear in which state the loan should be deemed to be "made" when the borrower and lender are located in different states. Proper structuring can influence where the loan is "made." This may involve consideration of federal law, applicable state law and governing law provisions of loan agreements. The FDIC takes the view that a loan is made where certain non-ministerial acts are performed, such as credit

### B. State Bank Usury Preemption and Colorado's Attempt to Opt Out

Federal preemption of state law has always been a complex and somewhat contentious issue. National banks are able to export the rates and fees of the state where the bank is located and preempt conflicting state laws. This authority derives from the National Bank Act and has been upheld by the United States Supreme Court.[277] As banks became larger and more complex and have expanded into multiple states, determining where a bank was located for purposes of exportation also became more difficult. In addition to the bank's home state, branch states could also be sued for purposes of rate exportation.

State-chartered banks, however, did not have the same statutory grant of authority to export rates and fees until passage in the 1980s of the Depository Institutions Deregulation and Monetary Control Act (*"DIDMCA"*).[278] This law put state banks on equal footing with national banks and allowed them to export their interest rates nationwide, preempting conflicting state laws. The Federal Deposit Insurance Corporation (*"FDIC"*) issued opinions that gave state banks essentially the same rights as national banks and further defined that a loan is made where one or more of the three non-ministerial functions are performed: making the credit decision, communicating the credit decision, and funding the loan.[279] However, DIDMCA provided one caveat that states had the ability to "opt out" of the state bank preemption for loans made in that state by enacting legislation specifically opting out.[280] Initially a few states opted out, but most (including Colorado) opted back in to federal preemption; Iowa and Puerto Rico are among those that did not opt back in.[281]

In 2023, the Colorado legislature passed a bill opting out of DIDMCA preemption for state banks which was signed by the governor with an effective date of July 1, 2024.[282] On March 25, 2024, three trade associations brought suit in federal court in Colorado seeking a declaratory judgment that the law was

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decisioning and loan funding. The analysis is complicated and raises potential preemption questions in states (like Colorado) that have enacted the Uniform Consumer Credit Code and that indicate loans are made where the borrower is a resident.

277 12 U.S.C. § 85.

278 Section 27 of the Federal Deposit Insurance Act.

279 FDIC General Counsel Opinions Nos. 10 and 11.

280 The preemption provisions are found in Sections 521–523 of DIDMCA while the opt-out provision is in Section 525.

281 The opt-out right was never codified per se in federal regulation and only appeared in a footnote to 12 U.S.C. § 1730g, part of the National Housing Act. In 1989 enactment of another federal law repealed 12 U.S.C. § 1730g, including the only statutory reference to the opt-out provision (Section 407 of FIRREA-103 Stat. 183). A Colorado appellate court ruled that the opt-out provision had been repealed and was not effective after 1989. *Stoorman v. Greenwood Tr. Co.*, 888 P.2d 289, 293 (Colo. App. 1994), aff'd 908 P.2d 133 (Colo. 1995).

282 H.B. 23-1229, codified as COLO. REV. STAT. 5-2-214. Proponents of the legislation claimed that this would eliminate high-rate predatory lenders from making loans to residents of Colorado. Opponents of the legislation pointed out that this would not affect national banks and would negatively impact Colorado financial institutions. Rhode Island, Minnesota, Nevada, and Washington, DC considered similar legislation but did not enact any opt-out of DIDMCA.

void and seeking injunctive relief to avoid the implementation of the law.[283] Most interesting, the FDIC filed an amicus brief favoring the position of the state, in essence attempting to distance itself from its own prior interpretations of where a loan was made.[284] After the change of federal administrations in 2025, the FDIC withdrew its brief.

The issue before the court is simply which state's law applies to loans made to Colorado residents by out-of-state banks. The plaintiffs' argument is that a loan is made in the state where the bank is located or performs one or more of those non-ministerial functions as provided by the long-standing FDIC guidance. Conversely, the State of Colorado's position is that a loan is made in the state where the borrower resides. In June 2024, the federal district court granted a preliminary injunction keeping the law from going into effect.[285] The court indicated that the plaintiffs would succeed on the merits of the case, accepting the notion that a loan is made by a bank and obtained or received by a borrower, which the judge said was consistent with how the FDIC statute uses the word.[286] The court concluded that loans are made by the bank and where a loan is made does not depend on the location of the borrower.

In July 2024, Colorado appealed the district court's decision to the Tenth Circuit Court of Appeals. The district court proceedings have been stayed pending resolution of the appeal in the Tenth Circuit. On November 10, 2024, the Tenth Circuit issued a lengthy decision reversing the district court's decision and remanding the case to that court for further proceedings. The court found that loans made in Colorado included loans made to residents of the state by out-of-state lenders. The dissent noted that the majority decision could find loans subject to the usury limitations of multiple states, resulting in uncertainty for lenders.

*Implications*. If the position of the State of Colorado ultimately prevails, it would present challenges to the marketplace lending industry. If other states opted out, there would be a return to a patchwork of rates and fees that inhibit a national offering of a credit product by state banks. The effects would go far beyond online lenders and affect the interstate lending operations of any state-chartered bank seeking to make loans into an opt-out state. States opting out are putting their own state-chartered institutions at risk as to preemption and exportation. Such a position would also put state banks at a competitive disadvantage since the opt-out would not affect national banks and as a result would not meet a stated objective of recent opt-out legislation—to stop higher-rate lending.

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283 *Nat'l Ass'n of Indus. Bankers et al. v. Weiser et al.*, Civil Action # 1:24-cv-00812. The other plaintiff associations are the American Financial Services Association and the American Fintech Council.

284 Contrary to this action, in another action upholding federal preemption for state banks the FDIC filed a brief to the effect that a loan is made for purposes of DIDMCA in the bank's state, not the state where the borrowers lived. *Greenwood Tr. Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992).

285 The injunction applies to members of the three trade associations only. The court noted in its decision that the question presented of where a loan is made had not been decided by any court and had been an open question since the statute's inception.

286 The court stated: "It follows, then, that the answer to the question of where a loan is 'made' depends on the location of the bank, and where the bank takes certain actions, but not on the location of the borrower who 'obtains' or 'receives' the loan."

***Usury—New York Case.*** Usury is a subject that continues to pervade marketplace lending law. Recently there was a clarification of New York usury law that is of import.[287] In considering the application of state usury laws, the Second Circuit Court of Appeals certified a question to the state court inquiring whether a loan that was criminally usurious was also void. While the statute dealing with civil usury specifically states that a loan in excess of civil usury (16% in New York) is void and unenforceable, the statute dealing with criminal usury (25% in New York) does not contain such a provision.[288] New York cases were also divided on whether a usurious loan to a corporation was void or subject to reformation given that corporations are not allowed to plead the defense of usury under the civil usury statute. The court determined that a loan in violation of the criminal usury statute is void.[289]

***Interstate Lending.*** In January 2022, the Third Circuit Court of Appeals found that applying Pennsylvania law to activities occurring out of the Commonwealth but to residents of the Commonwealth did not violate the commerce clause of the U.S. Constitution.[290] This case centered on a motor vehicle loan with a high interest rate to Pennsylvania residents from the lender's office located outside of Pennsylvania and included the entire lending process, from application to disbursement of funds. Pennsylvania issued a subpoena to the lender who stopped making the loans to Pennsylvania residents and sued the state regulator for lost revenue. The lower court found that Pennsylvania could not apply its usury laws outside of the state, as that would be in violation of the commerce clause. The appeals court overturned the decision, finding that the relationship existed beyond the making of the loan and that the state had an interest in protecting its residents even when conducting business out of state. The Supreme Court denied a petition to hear an appeal of the case. This law presents a host of potential issues to interstate lenders, particularly in the Third Circuit.

### C. Usury and Licensing

Usury and licensing issues remain a focal point of regulators and litigants. They have also resulted in legislative proposals to cap interest rates.

Many of the court cases have targeted tribal lending programs, which tend to be higher-rate programs and claim exemption from usury laws based on the doctrine of sovereign immunity afforded to Native American tribes. As a result, many of the cases allege that the links to the tribal underpinnings are a sham.[291]

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287 *Adar Bays, LLC v. GeneSys ID, Inc.*, Case No. 18-3023 (2d Cir. Mar. 15, 2022).

288 The civil usury statute is found at N.Y. GEN. OBLIG. LAW § 5-511 and the criminal usury statute is at N.Y. PENAL LAW § 190.40.

289 The opinions relating to this case can be found at 962 F.3d 86 (2d Cir. 2020) and 341 F. Supp. 3d 339 (S.D.N.Y. 2018). The court also found that a stock conversion option permitting a lender to convert a loan to shares of stock at a fixed discount should be treated as interest for determining usury.

290 *TitleMax of Delaware, Inc. v. Weissman*, Case No. 21-1020 (3d Cir. Jan. 24, 2022).

291 *See, e.g., Harris et al. v. Credit Cube et al.*, Case No. 1:23-cv-01153 (N.D. Ill.) (alleging unlawful lending using a tribe to avoid state law and interest rates), and, similarly, *Harris v. Eagle Valley Ventures et al.*, Case No. 1:23-cv-01114 (N.D. Ill.). Historically this publication has not attempted to cover tribal lending issues for a variety of reasons other than as they may impact

Regulators and litigants are also taking notice of licensing issues. In particular, states have been expanding licensing requirements for student loan lenders and servicers. Within the recent past, Kentucky and Louisiana have required licensing requirements for student loan servicers. Private litigants are also suing companies for damages for engaging in business without holding the appropriate licenses.[292]

## D. "Valid When Made" Litigation—Background of *Madden* Decision

### *1. Madden v. Midland Funding, LLC*

In 2015, the Second Circuit Court of Appeals issued an opinion finding that under the doctrine of federal preemption, a non-bank assignee of a bank loan could not charge and collect the rates and fees that the lending bank could charge and was therefore subject to state usury law limitations.[293] This ruling was somewhat surprising in that its finding was in opposition to decades of precedent establishing the concept of "valid when made," meaning that the terms of a loan that are valid at the inception of the loan do not change or become invalid when the loan is subsequently sold or transferred to another party. The decision was widely criticized and created uncertainty for marketplace lending programs that utilized loan or purchase arrangements involving banks, funds, investors, lenders, or, in connection with securitizations, asset-backed transactions or warehouse loans. As a result, some lending programs were either curtailed, suspended, or limited in the Second Circuit states of New York, Connecticut, and Vermont. Federal Reserve economists determined that consumer access to credit was reduced in those states as a result.[294] The May 2015 decision of the Second Circuit in *Madden v. Midland Funding, LLC,*[295] sent shockwaves through the marketplace lending industry, and for years later many of the questions generated by this case remained unanswered. Midland Funding's request for rehearing by the full Second Circuit and subsequent petition for review by the U.S. Supreme Court were both denied, and the February 2017 remand decision by the district court further muddied the waters. Even though the

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online lending programs generally. Tribal programs are fundamentally different from programs working with Funding Banks and the laws of federal preemption do not apply to tribal lending programs; conversely, sovereign immunity does not affect bank programs. Tribal programs are also more subject to litigation risk due to the high rates charged on such programs.

292 *See, e.g., Washington et al. v. TitleMax of Virginia, Inc. et al.,* Case No. 1:23-cv-00246 (M.D.N.C.). This action follows a similar proceeding in Pennsylvania where the Department of Banking issued a subpoena to a lender operating from a location in an adjacent state but marketing to Pennsylvania residents. The state alleged violation of its usury and licensing laws. The lender defended on the basis of the dormant Commerce Clause and due process. The Third Circuit found that the transactions did not occur totally outside the state. *TitleMax of Delaware Inc. v. Weissman*, Case No. 21-1020 (3d Cir. Jan. 24, 2022). The Supreme Court declined to hear an appeal of this decision.

293 *Madden v. Midland Funding, LLC,* 786 F.3d 246 (2d Cir. 2015), *cert. denied,* 136 S. Ct. 2505 (2016). The case is sometimes referred to as "*Madden.*" The doctrine of federal preemption allows federally insured depository institutions to charge the rates and fees allowed in the state where they are located, export those rates and fees to other states, and preempt any conflicting state laws. This doctrine and its associated case law are also discussed later in this book.

294 Jagtiani, Julapa, and Lemieux, Catharine, "Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information" (June 16, 2017) available at: https://www.fdic.gov/analysis/cfr/bank-research-conference/annual-17th/papers/14-jagtiani.pdf/.

295 786 F.3d 246 (2d Cir. 2015), *cert. denied,* 136 S. Ct. 2505 (2016).

case was ultimately settled and the OCC and FDIC have issued regulations to address the effects of this decision, those regulations may not even be subject to court deference and so this decision continues to predicate uncertainty for the marketplace lending market.

***Summary.*** In *Madden*, the Second Circuit held that a non-bank assignee of loans originated by a national bank was not entitled to the federal preemption afforded to the bank under the National Bank Act (*"NBA"*) with respect to claims of usury. Under the NBA, national banks can make loans at the rates and fees allowed in the state where the bank is located and "export" them nationwide without being limited by the usury laws of individual states where the bank's borrowers may reside. The court held that preemption of state usury laws does not apply to non-bank loan purchasers where the bank has no continuing interest in the transaction unless the state law would "significantly interfere" with the bank's exercise of its banking powers under the NBA. The court found that failing to extend federal preemption to non-bank loan purchasers would have no such impact on the bank. As a result, the court ruled that Midland, the debt collector and non-bank purchaser of a credit card account issued by a national bank to a New York resident, was required to adhere to New York usury limits.

> **Key Consideration:** *Madden* did not involve a marketplace lender or loan, but if the *Madden* holding were applied to a marketplace lender as a non-bank purchaser of an existing bank loan, the marketplace lender might be unable to enforce the loans in accordance with their terms or may be subject to claims of damages for charging excess interest.[296] *Madden* therefore has raised significant questions for the marketplace lending industry.

***Procedural History.*** In 2005, Saliha Madden, a New York resident, opened a credit card account with a national bank that was governed by Delaware law. Madden defaulted on the account and after it was charged off by the bank, it was sold to Midland Funding, a debt collector. A Midland affiliate sent Madden a letter calculating interest at 27% per annum. Madden filed a class action lawsuit in the Southern District of New York alleging that this rate violated New York's usury limitations. Midland constructed its defense on the principles of federal preemption based on the bank's contract and its ability to charge this rate under the NBA. Since the loans purchased were lawfully made, Midland argued that, as an assignee of the loan, it was exempt from compliance with the New York usury law. The federal district court agreed with Midland, and Madden appealed to the Second Circuit.

The Second Circuit reversed the decision of the lower court, finding that preemption worked for the benefit of non-banks only when application of state law would significantly interfere with the bank's exercise of its powers under the NBA. The Second Circuit also remanded the case to the lower court to determine if New York or Delaware law governed the contractual relationship of the parties. The account

296 Depending on the state, if a marketplace lender were found to have breached the applicable usury cap, it could render the related loans unenforceable in whole or in part and/or subject the lender to monetary or other regulatory penalties.

agreement specified Delaware law as the governing law, and Delaware authorizes creditors to charge any interest rate approved by the borrower in a written contract. Accordingly, the 27% rate that Midland sought to enforce would arguably be valid if Delaware law controlled.

> **Scope of Decision:** Although *Madden* is binding only in the states included in the Second Circuit (Connecticut, New York, and Vermont), there remains the risk that other jurisdictions will adopt the Second Circuit's analysis.[297] Some marketplace lenders and their Funding Banks have revised their business relationship to address *Madden* concerns.[298] In addition, some purchases and/or securitizations of marketplace loans have limited eligibility criteria to loans that comply with applicable usury rates in the states located in the Second Circuit or not included loans from those states in the loan pool. Some platforms have ceased operations in those states.

***Requests for Review.*** Following the Second Circuit's decision, Midland requested that the entire Second Circuit Court of Appeals rehear the case, but this petition was denied. In November 2015, Midland asked the U.S. Supreme Court to grant certiorari to hear the case. In its brief to the Supreme Court, Midland argued that the Second Circuit's decision violates the long-standing doctrine that loans are "valid when made" and do not change character or become invalid when they are sold or transferred.[299] In March

297 There are many good legal arguments why *Madden* is either distinguishable from marketplace lending programs or altogether wrong. For one, the debt involved in *Madden* was charged-off, defaulted debt. Also, failing to extend preemption to non-bank purchasers could prevent the bank from selling certain loans, or at least reduce the price at which the loans can be sold, and thereby significantly interferes with a bank's powers to make and sell loans. The *Madden* court also failed to apply long-standing precedents from other courts holding that an assignee steps into the shoes of the assignor and is entitled to enforce the loan upon the same terms as the assignor. These cases are consistent with the long-standing common-law principle that a loan which is valid when made does not become invalid when transferred. Since the *Madden* decision, some marketplace lenders have restructured their loan marketing programs to provide the Funding Bank with both a continuing relationship with the borrowers and a continuing financial interest in loan performance, including restructured compensation arrangements under which the bank's compensation is partly based upon the payments actually made by the borrowers over the life of the loans.

298 For example, in February 2016, WebBank, the bank which at that time was the lender for loans solicited through the LendingClub website, revised its borrower account agreement to specify that the bank maintains the account relationship with the borrower for the life of each and all LendingClub loans. In addition, WebBank and LendingClub modified their compensation arrangements so that WebBank's compensation was no longer front-loaded as a fixed origination fee calculated against the principal amount of each loan but instead is tied in part to the performance over time of the loans originated through the LendingClub platform. The revised borrower account agreement and compensation arrangements are intended to provide WebBank with an ongoing interest in each loan sufficient to protect the funding arrangements from a *Madden*-type challenge. Other marketplace lenders have engaged in similar restructuring. There have been no cases decided interpreting the validity of these arrangements.

299 *See FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981) (the identity of the original creditor is dispositive and the "non-usurious character of a note should not change when the note changes hands"); *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005) (assignments allow assignees to collect interest at the rate allowed to the originating creditor); *Munoz v. Pipestone Fin., LLC*, 513 F. Supp. 2d 1076 (D. Minn. 2007) (state law claims for excessive interest charged by an assignee of a loan are preempted).

2016, the Supreme Court requested the views of the Solicitor General of the United States on whether the Supreme Court should hear the case.[300]

In its brief to the Supreme Court, the Solicitor General strongly criticized the Second Circuit's analysis and called its holding incorrect.[301] The Solicitor General said that the "valid when made" doctrine was incorporated into Section 85 of the NBA, which provides banks with their preemptive powers. The brief also stated that the Second Circuit failed to consider the effect of its decision on the marketability of loans. The Solicitor General's brief is of particular significance because it was joined by the OCC, the federal regulator of national banks. However, the Solicitor General ultimately recommended that the Supreme Court *deny* certiorari for three reasons: (1) there was no circuit split on the question raised, (2) the parties did not present significant aspects of the preemption analysis to the lower courts, and (3) there was a possibility that Midland Funding could still prevail on remand.[302] In June 2016, after considering all of the briefing, the Supreme Court declined to hear the case.[303]

***Remand Decision.*** On February 27, 2017, the U.S. District Court for the Southern District of New York issued its remand decision. The district court held that applying Delaware law per the account agreement would violate a fundamental public policy of New York—namely, its criminal usury statute, which limits interest to 25% per year.[304] Broadly interpreted, this decision could prevent the enforcement of choice-of-law provisions in credit agreements against New York consumers when the interest rate exceeds 25%, as is the case for many credit cards and other consumer loans.

The district court also found that although the New York criminal usury law does not provide a private right of action, Midland Funding's violation of the usury limit could serve as a predicate for Madden's Fair Debt Collection Practices Act (*"FDCPA"*) and state unfair and deceptive acts and practices (*"UDAP"*) claims, which the court allowed to proceed on a class basis. Ironically, the usury claims that were the focus of the Second Circuit's opinion were dismissed by the district court.

The case proceeded upon theories related to debt collection claims. After notice and a fairness hearing, the case was settled and dismissed in September 2019. The settlement included a payment of $550,000 and a $9 million fund to provide credits to the accounts of borrowers, and payment of $550,000 in attorneys' fees.

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300 This request shows that the Supreme Court was interested in the potential effect of this case on the financial services industry and capital markets.

301 Brief Amicus Curiae of United States at p. 6, *Midland Funding, LLC v. Madden*, 136 S. Ct. 2505, 195 L. Ed. 2d 839 (2016) (No. 15-610).

302 *Id.*

303 *Midland Funding, LLC v. Madden,* 136 S. Ct. 2505, 195 L. Ed. 2d 839 (2016) (cert. denied). Interestingly, Madden's brief explicitly stated that this case is limited to the sale of defaulted debt and does not apply to marketplace lending.

304 Courts will not necessarily apply the governing law stated in a consumer loan agreement if doing so is viewed as contravening public policy in the borrower's state of residence. The *Madden* court noted that courts which have considered this issue under New York law in similar cases have reached differing results.

***Thoughts.*** The district court's holding compounds the uncertainty created by the Second Circuit's decision in *Madden* by further undermining common law principles that are routinely relied upon by creditors and their assignees. While the Second Circuit's decision undercuts the doctrine that loans are "valid when made" and do not become invalid when they are assigned to a third party, the district court called into question the enforceability of a choice-of-law provision in a credit contract against New York consumers where the interest rate exceeds the state law usury limits. However, the court did not directly address what happens when federal preemption and state public policy conflict. How similar cases in the Second Circuit (New York, Vermont and Connecticut) will be decided remains to be seen. Interestingly, a New York district court found the *Madden* analysis not applicable in a case involving state law claims brought by a consumer against a non-bank service provider to a national bank.[305]

***Illinois Court Cites Madden.*** In March 2017, an Illinois federal court denied a motion to dismiss state usury claims against a non-bank assignee of loans originated by a national bank on the basis of federal law preemption, determining that it was not clear which entity had made the loans.[306] In its decision, the court made the assertion in dicta (without any briefing) that *Madden* was the only appellate court decision addressing the issue of federal preemption as it applies to assignees.[307] Although it is not a finding on the merits of the *Madden* position taken with respect to assignees, this is at least one court outside the Second Circuit that has referenced the *Madden* decision approvingly and *Madden*-type claims will remain an area to watch. This case has subsequently settled on other grounds.

***Madden "Fix" Legislation Not Enacted.*** Various proposals referred to as Madden "fix" legislation have been made to invalidate the Second Circuit's decision in *Madden* and codify in federal statutes the "valid when made" doctrine that has served as court precedent for decades. The valid when made doctrine provides that a loan which is valid when originally made does not become invalid when it changes hands to an assignee. Specifically, the Madden "fix" legislation would invalidate the Second Circuit's decision in *Madden* finding that a non-bank loan assignee cannot enforce the terms of a loan made by a bank where (i) the term to be enforced violates applicable state law, and (ii) the bank no longer has any interest in the loan.[308] The Madden "fix" was contained in the CHOICE Act,[309] which was

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305 *See Edwards v. Macy's, Inc.*, 2016 U.S. Dist. LEXIS 31097 (S.D.N.Y. Mar. 9, 2016), where the court rejected a theory relying on *Madden* against a bank and its non-bank partner, finding that the non-bank partner was acting on behalf of the bank in carrying on the bank's business in originating and servicing loans and that state law claims were therefore preempted. The case was appealed to the Second Circuit but has been voluntarily dismissed.

306 *See Euls v. Transworld Sys., Inc.,* 15 C 7755, 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017). This case was settled on other grounds.

307 This statement is incorrect, as many of the cases cited in the *Madden* litigation have addressed the issue of loan assignees being able to take assignment based on the terms of the original loan made by the assignor.

308 There is some expectation that the 2020 regulations of the OCC and FDIC will have the effect of overruling *Madden* to the extent that a court would give deference to the federal agency's interpretation. See the "Recent Developments in Marketplace Lending Regulation" section regarding the Supreme Court overturning the *Chevron* doctrine. Deference no longer needs to be given to agencies and the courts may decide this question. A court challenge to the regulations failed and some courts have given deference to the regulations.

309 H.R. 10, Financial CHOICE Act of 2017.

passed by the U.S. House of Representatives on June 8, 2017, but stalled in the Senate. On February 14, 2018, the House of Representatives passed H.R. 3299,[310] a standalone bill that would codify the valid when made doctrine for loans made under various federal laws by regulated financial institutions. However, this bill died in the Senate, which never took a vote on the measure. While there was bipartisan support for the bill, consumer groups rallied in opposition claiming that this legislation would advance predatory payday lending. Therefore, uncertainty around the assignment of loans in the Second Circuit states of New York, Connecticut, and Vermont still remains.[311] This uncertainty became even greater when in 2019 two putative class action lawsuits were filed in two New York federal courts alleging that securitization trusts as non-bank assignees of credit card receivables received interest in violation of New York usury laws. These suits were ultimately dismissed. The import of such cases is significant given that the penalty in New York for usurious loans is voiding of the entire loan-principal and interest.

### *2. Suits Filed Against Credit Card Trusts Dismissed*

Few cases were filed on *Madden v. Midland* theories until June 2019 when two cases were filed against securitization trusts in two federal courts in New York.[312] In both cases, class action status was sought against defendants affiliated with two national banks that have acted as special purpose entities in credit card receivables securitization transactions sponsored by the banks. The actions sought to expand on the *Madden* decision by alleging that the defendants' acquisition, collection and enforcement of the banks' credit card receivables violate New York usury laws and that the securitization vehicles as non-bank entities are not entitled to the benefits of federal preemption and must be limited to collecting interest under state usury limits. The defendants filed motions to dismiss each action. In one of the cases, a federal magistrate judge recommended that the action be dismissed because it would interfere with banks' ability to exercise their federally granted powers. On September 21, 2020, the judge in this case (the *Petersen* case referred to in the footnote) granted the defendants' motion to dismiss. On September 28, 2020, the judge in the *Cohen* case granted the defendants' motion to dismiss with prejudice. These dismissals are an important development in that the cases, while not overruling *Madden,* found that different facts required a different result. Both courts distinguished the facts from the *Madden* decision, finding that unlike the *Madden* case where the bank had no continuing interest in the loan because the bank had sold the loan, in these cases the two national banks held a continuing

310 H.R. 3299, Protecting Consumers' Access to Credit Act of 2017.

311 The *Madden* decision has had both practical and operational consequences for marketplace lending programs and the broader financial markets. Some marketplace lenders have ceased to do business in the three affected states, while others only make loans in those states up to the applicable state's usury limit. Investors have shunned and securitizations have excluded loans from those states in an effort to reduce risk, and studies have indicated that *Madden* has to some extent limited access to credit in the Second Circuit region. *See* Honigsberg, Colleen; Jackson, Jr., Robert J.; and Squire, Richard, How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment, J. of L. and Econ. (Aug. 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215.

312 *Petersen et al. v. Chase Card Funding, LLC et al.,* Case 1:19-cv-00741-LJV (W.D.N.Y. filed June 6, 2019), and *Cohen et al. v. Capital One Funding, LLC et al.,* No. 19-03479 (E.D.N.Y. filed June 12, 2019). Decision at 489 F. Supp. 33 (E.D.N.Y. 2020). *See* Petersen order at 2020 WL 5628935 (Sept. 21, 2020).

interest in the loans including retention of the account and the continuing right to change interest rates. Both courts noted that the securitization situation was more like a case cited approvingly by the *Madden* court.[313] The courts found that the federal preemption applicable to the two national banks preempted New York usury laws. One court did not rely on the newly minted OCC rules on this topic, but approvingly alluded to the OCC's rationale in enacting the rule in its decision. The other court stated that it did not need to rule on that as it was moot under its analysis. The decisions also found that application of New York usury laws would significantly interfere with each national bank's right to sell and securitize loans. Appeals of both decisions were voluntarily withdrawn, depriving the Second Circuit of the opportunity to reconsider or clarify its *Madden* decision.

Initially, these filings created additional uncertainty in the investor and securitization markets.[314] The filing of these cases accelerated the momentum to act, prompting members of Congress to ask the federal banking agencies to address the issue. The FDIC and the Office of the Comptroller of the Currency (*"OCC"*) also filed an amicus brief in a bankruptcy action in Colorado as discussed below, stating that the court should honor the "valid when made" doctrine.

### E. Agencies Propose Rules

In November 2019, both the OCC and the FDIC issued proposed regulations that would codify the long-standing legal principle that a loan that is "valid when made" does not become invalid when sold, transferred or assigned. After a public comment period, both agencies adopted as a final regulation a substantially similar rule clarifying that interest permissible on a loan at the time it is made is not affected by the sale, assignment or transfer of the loan, even if to a non-bank assignee. As a result, both nationally chartered institutions and state-chartered institutions are covered by the promulgated and effective regulations.

### F. Final Rules Issued

On May 29, 2020, the OCC issued its final rule codifying as a regulation that the interest charged on loans that is permissible before the loan is transferred remains in effect after the loan is transferred. The one sentence regulation: "Interest on a loan that is permissible under 12 USC 85 shall not be affected by the sale, assignment or other transfer of the loan" will be codified for national banks at 12 C.F.R. pt. 7.4001(e) and a similar regulation for federal savings associations will be codified at

313 *Krispin v. May Dep't Stores*, 218 F.3d 919 (8th Cir. 2000) (finding federal preemption applicable to a bank's sale of 100% of its receivables on a daily basis to its department store affiliate).

314 Both cases, filed by the same attorneys, and having some overlapping plaintiffs, are somewhat curious in that the *Madden* decision favorably discusses a case where a bank retains the customer account but sells receivables generated, the precise situation involved in the securitization of credit card receivables. The Magistrate decision in the *Petersen* case was a recommendation to the trial judge and was opposed. However, in December 2019, the trial judge issued an order stating that he would consider the proposed regulations of the OCC related to the issue. Several amicus briefs were filed on both sides.

12 C.F.R. pt. 160.10(a). These regulations became effective August 3, 2020.[315] While these regulations are intended to clarify the agency's position relative to the Second Circuit decision, the promulgation also states that this rulemaking does not address which entity is the true lender of a loan.

The FDIC issued a similar rule applicable to state-chartered banks that became effective August 21, 2020.[316] The OCC has indicated that although adopted first, its rule is intended to function in the same way as the FDIC rule. The FDIC stated that its final rule is to clarify the ambiguity it perceived that a bank has the right to both make and transfer loans, and the rule protects the right of a bank to assign loans it makes according to its terms. It does not purport to allow state banks to assign their ability to preempt state law interest rate limits as allowed under federal law. Rather, the rule merely allows state banks to assign loans at their contractually agreed-upon interest rate.

Both agencies expressed the view that the interest statutes for national and state banks were ambiguous and created uncertainty that was fueled by the appellate court decision in *Madden v. Midland*.[317] The rules would alleviate such uncertainty and provide market stability. Both agencies went to great lengths to explain their rulemaking and why it was not subject to the Administrative Procedure Act,[318] or a pre-emption determination, or that the rule would result in predatory lending. Rather, each agency expressed displeasure with entities that attempted to use banks to evade interest rate restrictions.

While this OCC regulation and the FDIC regulation will not prohibit litigants from alleging *Madden* types of claims, the regulations should provide a potent defense to such claims and at minimum would knock out claims that a non-bank assignee is not entitled to enforce the interest rate terms of a loan made by a federally insured depository institution. Prior to 2024, under the *Chevron* doctrine[319] courts must consider giving deference to the interpretations of federal agencies with jurisdiction over certain entities or subject matter. Under this principle, courts should give weight to the opinions of the banking regulators and find that interest made at loan inception carries through to assignees. However, in 2024, the U.S. Supreme Court overruled this precedent, leaving it up to the courts to decide the issue. It would seem that courts would at least consider agency action in cases being decided, but that is up to each court to determine.

Both agencies stated in their Final Rules that a bank is entitled to charge interest at rates allowed in the state(s) where it is located and also has authority to assign loans. The OCC also stated that its regulation is designed to encourage responsible lending and provide better access to credit, citing studies indicating that access to credit declined after the *Madden* decision in the three states located in the

315 85 Fed. Reg. 33530 (June 2, 2020).

316 85 Fed. Reg. 44146 (July 22, 2020), to be codified as 12 C.F.R. pt. 33.4(e).

317 786 F.3d 246 (2d Cir. 2015), *cert. denied,* 136 S. Ct. 2505 (2016).

318 5 U.S.C. § 551 *et seq.*

319 *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984), overruled by *Loper Bright Enter. et al. v. Raimondo et al.,* 603 U.S. ____, 144 S. Ct. 2244 (2024).

Second Circuit. The FDIC cited similar studies and stressed that the rule reduces uncertainty in the secondary markets needed for capital and liquidity of banks, which in turn promotes the safety and soundness of depository institutions.

The OCC spent a large portion of its analysis of the regulation on rejecting claims made by public comments in opposition to the proposed rule, most importantly, that the OCC did not have the authority to issue the regulation. Under existing law, a statute must be ambiguous in order for the agency to issue a regulation. In this case, the statute was silent concerning interest terms when loan terms are assigned. Opponents said this was not an ambiguity, but the OCC stated that due to uncertainty presumably caused by the *Madden* decision, express interpretation was necessary to resolve the silence of the statute.

The OCC made several persuasive arguments in this regard. The first is that under federal law national banks have the right to enter into contracts and assign contracts, and the character and terms of a contract endure its assignment. In other words, interest terms shouldn't be treated differently based upon the status of an assignee; rather, the assignee steps into the shoes of the assignor. As the OCC stated, a contract should not be usurious depending on who is enforcing it, rather than who made it. Significantly, assignment should not alter a borrower's original obligation to repay the original terms that were agreed upon. While there is significant precedent on these points, the OCC was careful to state that these common law tenets served to inform the OCC's decision, but were not the sole basis of that decision. The agency gave short shrift to opponents who claimed the *Madden* decision foreclosed the OCC's rulemaking by stating that *Madden* neither considered nor decided the scope of Section 85 as to a national bank. It also disagreed with commenters who claimed the agency had exceeded its authority and didn't follow the provisions of the Administrative Procedures Act.

The OCC also made it clear that this regulation is not one dealing with preemption of state law; rather it is narrowly construing a statute that is rooted in and relies on state law. Some opponents contended that this rule would facilitate predatory lending. The OCC again disagreed and addressed the issue by stating that appropriate third-party relationships play an important role in the operations of banks and the economy and are better addressed in already-issued OCC guidance on third-party relationships rather than in a regulation dealing with interest rates.

The FDIC made similar observations in its promulgation. Both agencies strongly endorsed the rule as needed for clarifying what happens to interest rates on loans when they are sold, transferred or assigned as being consistent with the underlying statutes that allow for nationwide uniformity in lending and promoting safety and soundness precepts for liquidity management that were undermined by *Madden*. It would be illogical to apply the statutes to loans only held to maturity by a bank, as banks need to sell loans for liquidity purposes. To have uncertainty on the terms of the loans when they are sold negatively affects both the primary and secondary markets for loan sales.

For banks selling or securitizing loans, these regulations provide both clarity and certainty. If challenged by *Madden*-type theories, the federal regulations will assist banks and credit markets in feeling comfortable that loans made upon terms at the loan's inception should carry through until payment or maturity, no matter who holds the loan. It remains to be seen if litigation based on *Madden* theories will be deterred or dismissed but few cases have emerged following the issuance of the regulations. The OCC and FDIC rules are consistent with precedent dealing with contractual rules of assignment and will promote less volatility in the secondary markets dealing with loan sales.[320]

> Since both agencies state that these valid when made rules do not determine who is the true lender of a loan, the focus of challenges is likely to shift to true lender issues.

### G. Court Challenges to Regulations

Soon after the regulations became effective, the attorney generals of some states brought two lawsuits challenging the regulations, one against the OCC and the other against the FDIC.[321] The states claimed that enactment of the rules violated the federal Administrative Procedure Act and that the agencies did not have the authority to issue those rules. At the heart of the matter was the states' view that the rules promote "rent-a-bank schemes" and allow entities that are not banks effectively to ignore state usury limitations and interest rate caps. After procedural posturing and the submission of amici briefs from multiple sources, the parties in each case filed motions for summary judgment.

On February 8, 2022, the federal district court issued decisions in both cases ruling on the cross motions for summary judgment and rejecting the plaintiffs' challenge and finding in favor of both the OCC and the FDIC. The court found that the regulators were reasonably interpreting the banking laws under their jurisdiction. In addition, the court reasoned that the regulations did not regulate the conduct of non-banks, as they only provide a basis for regulated institutions to sell a loan "without altering the interest rate upon which [the bank] and the borrower initially agreed." The rules were within the agencies' regulatory purview and were neither arbitrary nor capricious. The court recognized that banks need to have the ability to sell loans for liquidity purposes and the regulations provided greater certainty to banks and the capital markets that promote safety and soundness considerations. This is in contrast to the *Madden* decision, which created a great deal of uncertainty. These regulations serve to counter *Madden* although that decision remains precedential in the Second Circuit until overturned.

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320 It is also significant that this final rule was one of the first official acts of Brian P. Brooks, who was the acting Comptroller of the Currency at the time.

321 *People of the State of California et al. v. The Office of the Comptroller of the Currency et al.*, Case No. 4:20-cv-05200 (N.D. Cal. filed July 29, 2020); *State of California et al. v. Federal Deposit Insurance Corporation*, Case No. 4:20-cv-05860 (N.D. Cal. filed Aug. 20, 2020), decision at 584 F. Supp. 3d 834 (N.D. Cal. 2022). The OCC plaintiffs included Illinois and New York and the plaintiff states in the FDIC case included those states, Massachusetts, Minnesota, New Jersey, North Carolina, and the District of Columbia.

The states did not appeal the district court decision; therefore, the regulations remain in force. However, the regulations did not consider the issue of who is the "true lender" on a loan for purposes of determining the proper interest rate on a loan. That doctrine is discussed elsewhere in this book. But with the "valid when made" rules in effect, the focus of regulatory scrutiny and litigation appears to be on the true lender issue.

> The "valid when made" regulations adopted by the OCC and FDIC diminish but do not eliminate *Madden* risk in the marketplace.

### H. Court Decision Upholds Agency Rules

However, at least one court case has already found that it must follow the OCC "valid when made" regulation and ruled that the bank's rates apply to a non-bank assignee, even though it appeared that the judge was inclined to rule otherwise had the rule not been in effect.[322]

That decision came from an appeal of a bankruptcy proceeding in Colorado. In the underlying action, a federal judge found that the interest rate on a promissory note made by a national bank remained valid in the hands of an assignee after the assignment of the loan.[323] The debtor appealed the decision to the district court including theories based on the *Madden* decision. The FDIC and the OCC filed an amicus brief in this action calling the *Madden* opinion "unfathomable" because it failed to consider the long-standing legal principle that a loan "valid when made" does not become usurious when assigned and under contractual principles of assignment. A college professor filed an amicus brief in opposition to the position of the federal banking agencies. The debtor also opposed the position of the agencies.

On appeal, even though the court found itself bound by the new federal regulations, the judge remanded the action for consideration of the true lender issues that might exist. The judge stated that if the bank is found to be the true lender, then the assignment upon the original terms is valid. But if the bank is not the true lender, the regulations would not be applicable.

This decision and the agencies' statements that the "valid when made" rule does not answer the question of who is the true lender on a loan mean that the focus of legal and regulatory actions will center on true lender theories.

### I. Courts Are Giving Deference to "Valid When Made" Regulations

Courts generally take into consideration and give deference to (but do not necessarily follow) the interpretations of federal agencies with jurisdiction over certain entities or subject matter. This is called

322 *See, Rent-Rite Super Kegs West Ltd. v. World Bus. Lender, LLC*, Case No. 1:19-cv-01552-RBJ (D. Colo. Aug. 12, 2020).

323 *In re: Rent-Rite Super Kegs West Ltd.,* Adversary Proceeding No. 18-1099-TBM, 603 B.R. 41 (Bankr. D. Colo. 2019).

the *Chevron* doctrine.[324] Court decisions have followed the guidance found in the "valid when made" regulations. However, in 2024, the U.S. Supreme Court overruled the *Chevron* doctrine and now courts are not required to find deference to agency action or interpretation and may substitute their own wisdom on those subjects. Whether this development will generate additional litigation or disparity of court decisions remains to be seen.

In April 2021, a federal court in Massachusetts gave deference to the newly minted rules.[325] There, a bank service provider designed and marketed a student loan program where the loans were funded by a national bank and then sold to a trust established by the service provider. A borrower and co-signer sued the trust on the grounds that the loan exceeded the 6% usury rate set by Pennsylvania law. The defendant filed a motion to dismiss. The court dismissed the action against the trust on the basis of the loan being valid when made. The court also found the bank to be the true lender on the loan. The decision stated that the interest rate on the original loan was not usurious and therefore it could not become usurious when assigned, giving deference to the OCC regulation.

The policy implications of *Madden* were outlined in a Ninth Circuit opinion in late 2020.[326] The opinion noted the importance of the ability of financial institutions to sell loans into the secondary market and obtain liquidity in order to make more loans. The court stated: "Allowing states to impose a panoply of requirements on loans originated by savings associations impedes the securitization of those loans by (1) creating substantial uncertainty for buyers in the secondary market about the applicable law governing the loans they are purchasing and (2) imposing substantial compliance costs on secondary buyers." The court went on to describe what happened in the wake of the *Madden* decision:

> In the wake of *Madden*, the secondary market "significantly reduced the price of notes backed by above-usury loans to borrowers in Connecticut and New York." Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from A Natural Experiment*, 60 J.L. & Econ. 673, 675 (2017). Lenders also extended "relatively less credit to borrowers" and "discount[ed] notes backed by above-usury loans to borrowers in Connecticut and New York." *Id*. at 675, 691. "Not only did lenders make smaller loans in these states after *Madden*, but they also declined to issue loans to the higher-risk borrowers most likely to borrow above usury rates." *Id*. at 675; *see also* Piotr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy 22* (2018),

324 *Chevron U.S.A., Inc. v. NRDC,* 467 U.S. 837 (1984), overruled by *Loper Bright Enter. et al. v. Raimondo et al.,* Case No. 22-451, 603 U.S. ____, 144 S. Ct. 2244 (2024).

325 *Robinson and Spears v. Nat'l Collegiate Student Loan Trust 2006-2*, 2021 WL 1293707 (D. Mass. Apr. 7, 2021). The case also found the bank to be the true lender on the loan. The case is currently on appeal to the First Circuit.

326 *McShannock v. JP Morgan Chase Bank, N.A.*, 976 F.3d 881 (9th Cir. 2020).

https://tinyurl.com/y5s3s7oh (noting a 64% decrease in the volume of lending to low-income households in the wake of *Madden*.)

> *Madden* remains precedent in the Second Circuit and it is not known if or when the decision will be reconsidered or overturned.

Since the regulations have been enacted, it appears that the trend is for courts to give deference to those agency determinations, providing a modicum of certainty in the midst of the storm that occurred after the *Madden* decision. However, because courts are not required to even give that deference, the shadow of *Madden* still hangs over the marketplace lending industry and remains a risk factor, albeit likely diminished. Hence, the shift of focus of both regulation and litigation has been toward true lender issues.

### J. Issues Related to the Funding Bank Structure

As described above, it is often desirable for marketplace lenders to utilize the services of a Funding Bank in order to operate a consumer loan platform, in particular, to establish preemption of various state usury laws. However, the use of a Funding Bank raises several issues including availability, regulatory concerns including vendor management requirements and "rent-a-bank" criticism, and the potential of litigation based on who is the "true lender" for the program.

***Availability.*** Although the marketplace lending industry has grown exponentially in the last few years, only a small number of FDIC-insured banks are currently operating as Funding Banks. Most of them are smaller institutions. Trade publications indicate that these banks are receiving scores of inquiries related to serving as a Funding Bank for marketplace lenders. This demand is likely to increase the fees charged by Funding Banks to provide origination and funding for Borrower Loans. Some Funding Banks may also limit the number of marketplace lenders they work with. In addition, the rapid growth of these programs and increased scrutiny by their regulators has led to increased due diligence and compliance requirements for their marketplace lender partners.[327] Recent enforcement actions against banks working with fintechs also may pump the brakes on availability of Funding Banks. As might be expected, some banks are emulating marketplace lenders by offering bank loans through an online platform, often branded differently from the bank's main website. This eliminates the third-party service provider aspect of the relationship and makes the bank directly responsible for the program. Direct lending by banks also alleviates the risk of litigation under "true lender" theories.

327 Funding Banks will require their third-party service providers to have extensive policies and procedures to promote compliance with applicable laws and regulations. Funding Banks may also require ongoing audits of those service providers in areas such as Bank Secrecy/Anti-Money Laundering, compliance management systems, technology systems/information security and complaint resolution processes. Bank examiners are now reviewing marketplace programs under the interagency guidance related to risk management of third-party service providers.

***Bank Vendor Management Requirements.*** In recent years, federally insured institutions have been subject to new and expanded guidance on programs they have with third-party service providers.[328] In short, this guidance requires banks to conduct due diligence on proposed third-party arrangements, enter into agreements that protect the bank from risk (or effectively manage or mitigate identified risks), and monitor the third-party service provider, and it mandates that the service provider take corrective action where gaps or deficiencies occur. This guidance is in addition to the existing legal framework provided by the Bank Service Company Act,[329] which requires service providers to comply with laws and regulations applicable to the bank and subjects them to supervision and examination by the bank's primary federal banking regulator.[330] Banks that enter into arrangements with marketplace lenders will be subject to these rules for their programs. This means that a marketplace lender will undergo scrutiny from its Funding Bank, and startup companies or other entities without a track record may not meet the Funding Bank's standards or may have to agree to additional burdens or restrictions in order for the bank to justify the third-party relationship. Regulators upped the ante in issuing risk management guidelines for third-party relationships in June 2023 and followed with enforcement actions and consent orders for some Funding Banks.

## IV. THIRD-PARTY RISK MANAGEMENT AND ENFORCEMENT ACTIONS

### A. Cross River Bank Consent Order

In March 2023 the FDIC entered into a consent order, made public at the end of April 2023, with one of the largest bank participants in marketplace lending, Cross River Bank. This was the opening salvo against banks using third-party service providers in "banking as a service" or BaaS. The basis of the order related to fair lending issues and provided some restrictions on third-party programs. No new third-party programs or products will be allowed unless the FDIC issues a non-objection. It seems the FDIC was concerned that the bank did not have access to information so as to allow it to monitor fair lending issues. As a result, the bank will be required to have access to information to allow it to monitor fair lending compliance. The bank will also be required to conduct risk assessments of each third-party program and assess the fair lending compliance of those third-party programs. Reflective of these issues, the bank will also need to develop or revise policies and procedures related to third-party fair lending compliance.

### B. Interagency Guidance on Third-Party Risk Management

On June 6, 2023, the federal banking regulators (the OCC, the FDIC and the Federal Reserve) issued "Interagency Guidance on Third Party Relationships: Risk Management" (the *"Guidance").* This new

328 *See, e.g.,* OCC Bulletin 2013-29, FDIC FIL-44-2008 and CFPB Bulletin 2012-03.

329 12 U.S.C. §§ 1861—1867.

330 12 U.S.C. § 1867. The institution must also provide notice to its federal banking regulator of the third-party arrangement and provider.

issuance rescinded prior promulgations on this subject and provided a consistent regulatory approach to the use of third parties who assist banks in carrying out their banking functions and providing products and services. Although generic and principles-based in most respects, it was thought that this issuance was aimed at banks working with fintechs and foreshadowing increased supervisory scrutiny on bank relationships with financial technology companies.

The Guidance follows many of the prior guidelines prescribed for service provider relationships and begins with the need to assess risk, recognizing that risk management should be commensurate with the risk posed by the particular relationship involved with the financial institution.

The Guidance focuses on the life cycle of a third-party relationship beginning with the planning stage, continuing with due diligence on, and selection of, the service provider. Emphasis is placed on ensuring that the service provider is operationally and financially capable of providing the services contemplated. Contract negotiation principles and protection of the institution are discussed. The Guidance emphasizes the need to monitor the third-party relationship and indicates that there should be escape valves so the institution can terminate a relationship if necessary.

The Guidance also discusses the need for the bank's oversight of the service provider and makes quite clear that the delegation of responsibilities to a third party does not relieve the bank of its responsibilities for compliance with the law and regulation. The institution needs to have mechanisms to supervise the third party, including independent reviews and adequate reporting and documentation. In addition, the regulators specified that the third-party service providers themselves are subject to examination by the banking authorities.[331]

Then, in May 2024, the OCC, the FDIC and the Federal Reserve jointly issued a guide for community banks.[332] This guide repeats many of the principles and precepts found in the Guidance but again emphasizes that relying on third parties generates risk for which the bank cannot escape responsibility for compliance with laws, including those related to fair lending, unfair and deceptive acts and practices, fraud or money laundering. The guide also stresses the points of the importance of appropriate risk assessment, oversight and monitoring of the third party and good governance practices over the life cycle of the third-party relationship: planning, diligence and selection, contract negotiation, monitoring, termination and supervisory examination.

With the issuance of the Guidance, it was anticipated that the document would be used as a basis for conducting supervisory reviews of institutions, including with respect to fintech relationships, and could lead not only to greater scrutiny but also to increased enforcement. This indeed came to fruition as

331 This is not a new requirement, however; under the Bank Service Company Act, service providers have been subject to supervision and examination as an adjunct of the bank itself. 12 U.S.C. § 1867(c).

332 OCC Bulletin 2024-1, FDIC FIL-19-2024, Federal Reserve SR 24-2/CA 24-1.

several banks working with marketplace participants came under enforcement actions and consent orders, mostly at least in part based upon deficiencies found in those third-party relationships.

### C. Proliferation of Bank Enforcement Actions Related to BaaS and Third Parties

Based in part upon the Guidance and more specific attention being paid to BaaS programs, banking regulators have entered into consent orders or other regulatory sanctions with banks who work with BaaS service providers, principally fintech relationships. Generally, these actions require evaluation of those relationships, impose stricter monitoring of service providers and the taking of corrective action to mitigate perceived high risk practices or to bring programs into compliance with applicable laws and regulations. In some instances, the banks must seek regulatory approval in order to engage with new service provider relationships. Many of the actions emphasize the importance of compliance with the Bank Secrecy Act (*"BSA"*) and other laws related to anti-money laundering (*"AML"*) and regulations that are often outsourced to third parties. A brief description of these actions (in date order) appears below:

#### *1. OCC Consent Order—Blue Ridge Bank, N.A.*[333]

In January 2024, the OCC entered into a consent order with this Virginia-based national bank. The order indicates that examinations found deficiencies in the bank's BSA/AML program primarily related to third-party programs. Like many of these types of regulatory orders, the OCC required the establishment of expanded board of director oversight and a Compliance Committee, third-party evaluations, development of action plans and revised policies and procedures.

In particular the OCC required the assessment and management of the risks of third-party relationships, including with fintechs. It also required additional monitoring and auditing of those relationships. Specific attention was cited to the need to address deficiencies in customer due diligence and identification programs and reporting of suspicious activity. The regulator required a "look back" of suspicious activity with possible remediation to occur as a result. Notably, the OCC restricted the bank from engaging in any new relationships or expanding existing relationships without the non-objection of the OCC.

#### *2. Lineage Bank—FDIC Consent Order*[334]

Also in January 2024, the FDIC entered into a consent order with Lineage Bank related specifically to its fintech programs. The order required additional board and management oversight of those programs and additional training and audit in various areas, including BSA and AML. Like the previously described OCC order, the FDIC also required a look back of suspicious activity and reporting. In addition to

333 OCC Consent Order – Docket AA-ENF-2023-68 (Jan. 24, 2024). The consent order replaced a pre-existing Formal Agreement between the bank and the OCC stemming from August 2023. Late in 2023, the bank began offloading fintech programs and has largely exited the business.

334 FDIC 23-0041b (Jan. 30, 2024).

obtaining FDIC non-objection for new relationships, the FDIC laid out some details about diligencing a prospective new service provider. These included a risk assessment of that entity, including operational, financial and compliance wherewithal to engage in the proposed activity and an evaluation of that proposed party's ability to comply with law and with the bank's policies and procedures. Also of note is that the order inhibited any further deposit growth until an appropriate risk management program was in place.[335] Unlike other orders, the regulator also required reporting to be made to the regulator in the case of a termination of a relationship with a fintech, the impact of such a termination and how it would be handled by the bank.

#### *3. Sutton Bank—FDIC Consent Order[336]*

In February 2024, the FDIC entered into a consent order with Sutton Bank, working primarily with fintechs on prepaid card or other transactional types of products. Compared to some of the other orders, this order was relatively short and confined primarily to third-party risk management of BSA/AML compliance resulting from more recent examinations conducted of the bank. The order required an inventory to be made of third-party relationships and designation of BSA/AML responsibilities in those programs. Like other orders, it also required additional oversight of third parties. As to the BSA/AML programs, the order specified the need for a full-time BSA officer, a board committee devoted to BSA, appropriate staffing and resources and auditing for compliance of the third parties. Again, a look back was required with respect to suspicious activity transactions.

#### *4. Piermont Bank—FDIC Consent Order[337]*

In February 2024, the FDIC entered into a consent order with Piermont Bank of New York City. The FDIC found a lack of proper internal controls and information systems as to its third-party relationships. Like other orders, the FDIC was concerned that the bank did not have adequate information or access to adequate information to assess compliance of its third-party relationships. As a result, improvements and correction of deficiencies were required so the bank can adequately monitor and supervise those service providers.

335 In addition to lending programs, many fintech programs offer deposit types of services including cash advances which place customer funds into an aggregated custodial type of account (such as an FBO—for the benefit of account) usually at the bank where it is the service provider. This places deposits at the bank and allows transactions to occur by the consumers with respect to those funds and, if certain requirements are met, funds can be insured by the FDIC on a pass-through basis. *See* 12 C.F.R. pt. 330.

336 FDIC 23-0110b (Feb. 1, 2024).

337 FDIC 23-0038b (Feb. 27, 2024).

#### *5. Evolve Bancorp, Inc. and Evolve Bank & Trust—Federal Reserve Cease-and-Desist Order*[338]

The Federal Reserve brought a cease-and-desist action against this bank, a large participant in the fintech space, and its holding company. Although the order speaks of deficiencies found during an examination of the bank, the action occurred shortly after a service provider to the bank encountered financial difficulties resulting in bank customers being unable to access funds held at the bank.[339] The company was what is called a "middleware" provider. It sat between the bank (with whom it had a contractual relationship) and various fintech customers of the bank providing services to consumer end users, in this case deposit accounts and payment processing services to the fintechs and their customers. When financial difficulty ensued, end users were unable to access funds, which created both attention and publicity as to bank and fintech programs.

Soon after, the Federal Reserve entered its cease-and-desist proceeding in June 2024. It was based on risk management and AML deficiencies found in examinations and required additional resources to bring the bank into compliance. The order requires a third-party review of the bank's third-party relationships. Additionally, the bank must assess the risk of those programs, be sure that it has access to information and have the ability to monitor them. The order also placed emphasis on customer due diligence and transaction review and monitoring. Prior approval must be obtained for any new fintech partner, business, product or program. The FDIC will also require an impact analysis of the termination of any fintech program and of how the bank will handle program departures.

**Conclusion.** It is clear that all of the bank regulators are engaging in greater analysis and enforcement of laws and regulations where banks are working with fintechs, and those regulators are holding those banks responsible for engaging and managing those relationships in a safe and sound manner. This also means that the emphasis that will be placed on regulatory compliance will increase and the monitoring of third parties will become more rigorous. This could deter additional banks from entering the space due to compliance costs and responsibilities and make it more difficult for new entrants to find banking relationships, or make such relationships more costly and less flexible.

### D. Statement of Regulators and Request for Information

Suggesting continued emphasis and scrutiny of bank-fintech relationships and in particular of deposit account practices, on July 25, 2024, the FDIC, the OCC and the Federal Reserve issued a "Joint

338 *In re Evolve Bancorp, Inc. et al.,* Docket Nos. 24-012-B-HC, 24-012-B-SM.

339 On April 22, 2024, Synapse, a service provider to the bank, declared bankruptcy in California. This occurred during a winddown of a program with the bank and several fintechs. Former FDIC Chair Jelena McWilliams was appointed as trustee in the bankruptcy and has been working with various parties, including the bank, to be sure that customer funds are returned, although the return of some of those funds has been delayed due to this situation.

Statement" on bank arrangements with third parties.[340] The Joint Statement identifies areas the regulators see as high risk and also summarizes practices that can be used to manage risk. The regulators began with support for responsible innovation with third parties consistent with safe and sound banking practices and in compliance with applicable law.

Areas of risk identified were operational risk, compliance risk, risk of growth that is too fast and customer confusion, including as to the representation of whether funds are FDIC insured or not. Although addressing risk may be specific as to service providers of products and services, the agencies identified the importance of certain risk mitigants such as applicable policies and procedures, adequate staffing and resources and appropriate controls, monitoring and audit. These include heightened due diligence of vendors, contractual protections and the ability to monitor and take corrective action. As with the above-described enforcement actions, the regulators emphasized the need for information systems that provide the bank with data necessary to see, monitor and review practices. All the agencies reaffirmed that outsourcing to third parties to perform certain functions does not diminish the bank's responsibility to comply with all applicable laws and regulations.

At the same time, all three banking regulators issued a "Request for Information," or RFI, related to bank relationships with fintechs.[341] The RFI is broad in scope, covering deposit products, payment services and lending. The RFI solicits input on the nature of bank-fintech relationships, effective risk management practices in those arrangements and the implications, including "whether enhancements to existing supervisory guidance may be helpful in addressing risks associated with these arrangements."

While in the past cooperation between banking regulators has not always been cordial, with respect to innovation and third-party relationships, those agencies appear to be on the same page and consistently working with each other in a coordinated fashion. While the outcome of the RFI may not be known for some time, it can only be natural to expect that the agencies will attempt to issue additional guidance as to perceived flaws in bank-fintech combinations, and particularly on additional or add-on products that encompass more than lending, such as deposit/prepaid services.

## V. PROPOSED REGULATIONS TARGET MARKETPLACE PROGRAMS

The FDIC originally proposed regulations that potentially impact the relationship of banks and their fintech service providers. These include proposals related to brokered deposits, access to third-party information and industrial banks.

340 *Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services*, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (July 25, 2024).

341 Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses, 89 Fed. Reg. 61,577 (July 31, 2024).

### A. Brokered Deposits Rule

On July 30, 2024, the FDIC approved a notice of proposed rulemaking related to brokered deposits.[342] In substance, the proposal expands the definition of what constitutes a brokered deposit and eliminates exceptions that previously applied. The effect would be to subject to the rule some fintech programs that have deposit aspects of the program.[343] In proposing the rule, the FDIC indicated that the failure of a non-bank deposit broker precipitated the action. In addition, the FDIC indicated that risk is enhanced if banks rely on brokered deposits for funding purposes. It has been speculated that the FDIC could use this rule to regulate bank relationships with both crypto and fintech companies. It would also significantly increase the percentage of deposits that would be viewed as brokered.

Several financial services trade groups have asked the FDIC to withdraw the rule for various reasons, including that a major overhaul of the rule took place in 2020 on which the industry is relying and which would be reversed in part by this rulemaking, and they feel that the changes do not seem to be justified by existing data. Brokered deposit data is also used to analyze whether financial institutions are subject to risk and potential failure, as those deposits may be moved, so the increase in the amount of brokered deposits could cause unnecessary concern about the safety and soundness of institutions seeing an uptick in that category of deposits. In March 2025, the FDIC withdrew this proposed rule, effective on publication in the Federal Register on October 29, 2025.

### B. FDIC Proposed Rule on Custodial Accounts—Recordkeeping Requirements

On September 17, 2024, the FDIC issued a proposed rule that would apply to custodial accounts with transactional features and require banks to either ledger those accounts or have access to the ledger of a third party who is keeping the accounts on a real-time basis and to reconcile the accounts on a daily basis. As fintech programs moved beyond pure lending products, several programs that accept funds on behalf of consumers and businesses and place them in a consolidated custodial account such as an FBO (for the benefit of) account indicated that there are several beneficial owners of funds in the account. If certain recordkeeping requirements are met, funds are also available to receive FDIC insurance in the event the institution would fail.[344] Many of these programs allow end users to direct the fintech to transfer funds in and out of the custodial account on behalf of the customer. The FDIC

342 12 C.F.R. § 337.6.

343 For example, the exclusive deposit placement arrangement exception would be eliminated. Thus, a fintech that has a program that places deposits with one bank exclusively would no longer be exempt from the broker deposit rule.

344 The FDIC has also cracked down and issued cease-and-desist actions where the availability of deposit insurance has been misrepresented, in particular with providers of cryptocurrency services. While funds held at an insured depository institution may receive pass-through FDIC insurance (if the bank or the third party maintains accurate records to identify the owner of the funds and the amount of its funds), funds are not insured in the event the third party fails, but only if the bank fails. The FDIC has required third parties to accurately note that FDIC insurance only applies to funds held by the institution in the event the institution fails.

noted that it wants to ensure that the bank has the ability to provide funds even if the third party fails.[345] Accordingly, the FDIC's rule is applicable to custodial deposit accounts with transactional features. The three requirements to meet this standard are that (1) the account is for the benefit of others (*i.e.,* it is FBO or custodial in nature), (2) the omnibus account (usually established by the fintech) holds commingled deposits of numerous persons or entities and (3) the owner of the funds may direct the accountholder (typically the fintech) to transfer funds to others such as to make purchases or pay bills. If these requirements are met as to such accounts, banks would either have to maintain the ledger for the accounts that third parties open at the bank or be able to have direct and unrestricted access to the ledger information of the third party as to those accounts.[346] The bank would need to reconcile the ledger at the close of each business day, be able to validate the accuracy of the ledger and make an annual certification of its reconciliation of FBO accounts.

While the final rule may be forthcoming, it appears the new requirements for banks and their third-party service providers that have programs utilizing custodial accounts for beneficial owners of funds will be operationally and technically impacted by the new rule.[347]

### C. FDIC Proposed Rules on Industrial Banks

Industrial banks, while insured by the FDIC, are a special type of entity that is not considered to be a bank for purposes of the Bank Holding Company Act. Parent companies of industrial banks do not have to be registered under that law and do not have to be solely engaged in banking and activities closely related to banking. As a result, some industrial banks have been owned by non-banking, commercial companies and subject to criticism as a back door into banking. This came to a head a few years ago when Walmart attempted to obtain an industrial bank charter. Most industrial banks are located in Utah where there are no usury restrictions. Some industrial banks engage in higher-rate lending, making these entities subject to additional criticism. More recently, the FDIC has been concerned with the parent companies of industrial banks previously setting out requirements for foreign holding companies.[348]

On July 30, 2024, the FDIC issued proposed changes to its regulations concerning holding companies of industrial banks.[349] In essence, the proposed rule gives the FDIC greater ability to supervise industrial banks and the parent company of the institution. One of the major concerns of the FDIC is that the institution is a captive of the parent and the agency wants to be assured that the institution can function

345 In its issuance of the proposed rule, the FDIC specifically mentioned the Synapse bankruptcy that resulted in some customers not having access to funds in the custodial accounts at banks using the Synapse program.

346 https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-354.

347 For example, system interfaces may be needed in order to access and share data. A reconciliation process will need to happen daily. The proposed rule would also require validation of the accuracy of the data. Additional contractual considerations may be necessary in the service agreements between the bank and its service provider.

348 86 Fed. Reg. 10703. Rule effective April 1, 2021.

349 89 Fed. Reg. 65556 (Aug. 12, 2024).

independently, without the parent, if necessary. The proposal requires an industrial bank to meet the convenience and needs of the communities it serves. It also clarifies that the FDIC can supervise entities that obtain control of the industrial bank whether through conversions of other institutions, a change of control of the parent or other situations whereby the industrial bank becomes owned by a company not already subject to bank regulation.

In recent years, the FDIC has granted deposit insurance to few industrial banks. The proposed rules are seemingly another nail in the coffin of industrial banks by potentially exercising more authority over their parent companies. However, in July 2025 the FDIC withdrew the proposed rules and issued a request for public comment on how it should evaluate industrial banks and their parent companies.

In response to the increased regulatory scrutiny on third-party arrangements, some Funding Banks are tightening their due diligence requirements and demanding up-front policies and procedures from marketplace lenders with respect to legal and regulatory compliance. Funding Banks are likely to seek contractual and other protections in structuring their third-party relationships to minimize risk of loss. Funding Banks will also be required to monitor the activities of their service providers and subject them to audit, and bind their service providers to strict compliance and information security requirements.[350]

> **Key Consideration:** As a result, marketplace lending arrangements with Funding Banks are likely to become more complex and costly. Practically speaking, a marketplace lender will have to give up some degree of control over its lending program in order to accommodate the regulatory regime applicable to its Funding Bank.

***"Rent-A-Bank" Criticism.*** Funding arrangements where a bank contracts with a third party to provide origination services to bank customers have sometimes been criticized as "renting a bank charter," particularly in the context of payday loan marketers.[351] The perceived improper use of a bank charter by these entities has been challenged by both governmental authorities and private litigants, in part because of the high rates and fees charged to consumers in those payday lending programs which are fundamentally different from marketplace loans that are lower rate, longer term and do not renew. Bank regulators have even required banks to exit third-party programs that the regulators determined

350 Funding Banks are required to have control over all aspects of the loan program including setting the underwriting criteria for the program, approval of all consumer facing and marketing material, and adherence to bank's collection policies. The program will require regular reporting to the Funding Bank by the marketplace lender. Often the marketplace lender is required to pay for the Funding Bank's costs of compliance and audit. Typically, the marketplace lender will fully indemnify the Funding Bank as well. Most of these types of operational requirements are part of the August 2020 settlement of the Colorado Attorney General with two online programs discussed in the true lender section of this book in order to provide loans to Colorado residents.

351 As used in this book, payday loans are small-dollar (*e.g.,* $500), short-term (*e.g.,* two weeks), unsecured loans that borrowers promise to repay out of their next paycheck or regular income payment. In addition to charging borrowers a stated rate of interest, payday loans are usually priced with a fixed-dollar fee (*e.g.,* $3 for every $25 borrowed), which represents the finance charge to the borrower. Because payday loans generally have a short term to maturity, the total cost of borrowing, expressed as an annual percentage rate, can typically be in excess of 400%.

involved unsafe and unsound practices. However, most of these programs have involved high-rate payday loans. Both the OCC and FDIC have stated that bank charters should not be used as a means to evade state law requirements.

However, some banks may legitimately seek a competitive advantage by contracting with marketplace lenders to enhance the bank's product offerings, extend the area in which it makes loans and diversify assets. For example, some small community banks have entered into arrangements with marketplace lenders to originate consumer loans to their customers. Even larger banks have engaged in these types of programs, including for business and commercial loans.[352] These programs offer Funding Banks additional fee income generally at acceptable levels of risk, which arguably enhances the safety and soundness of the institution. However, regulators may become concerned if a bank concentrates too much of its portfolio in one area. Thus, it is possible that regulators could limit the number or size of these third-party marketplace lending programs based on safety and soundness concerns.

**Worth Remembering:** To ensure its own compliance with applicable laws, the Funding Bank will likely require the marketplace lender to implement policies and procedures demonstrating regulatory compliance and agree by contract to comply with laws that are binding on banks but may not be directly applicable to the lender.[353] The Funding Bank may also require the lender to submit to compliance protocols or audits and to take corrective action if deficiencies are found. Accordingly, financial institution laws and regulations—in addition to the consumer protection laws discussed below—will have a significant impact on the platform structure and operations where a Funding Bank is involved.

## VI. TRUE LENDER LITIGATION

### A. Background of True Lender Litigation

Perhaps the most significant legal risk facing many marketplace lenders is "true lender" litigation. The platforms most at risk are those that (i) market loans via the Internet, (ii) typically enter into contracts with service providers for federally insured depository institutions (called *"Funding Banks"*) who originate and fund the loans the platforms have marketed, (iii) purchase loans from a Funding Bank at or shortly after origination and (iv) continue to service the loans throughout the life of the loans. At the highest risk, and the most likely to be sued, are platforms where the loans are made at higher rates of

352 On the commercial side, it was announced in 2015 that JP Morgan Chase has entered into a relationship with OnDeck, an online commercial marketplace lender, to refer small business customers to OnDeck. OnDeck also worked with PNC Bank. Similar arrangements exist with others in the marketplace, including an arrangement between Kabbage and Santander Bank. Avant has worked with HSBC. However, some of these programs are no longer in existence.

353 As discussed herein, marketplace lenders may also be considered to be vendors of the bank and subject to the Bank Service Company Act and vendor management requirements. This makes the marketplace lender, as a service provider to the bank, responsible for complying with applicable laws and regulations and subject to examination by the regulators of the bank.

interest. In a "true lender" action, a borrower or regulator claims that the "true lender" of a loan made by a Funding Bank is the platform—not the Funding Bank—because the platform marketed the loan, has the "predominant economic interest" in the loan (insofar as it has purchased the loan or a large participation therein) and/or is engaged in other related activities such as loan servicing.[354] Some causes of action are brought on the basis that under the "totality of circumstances" the platform should be considered the lender. This question of whether the platform or the Funding Bank is the "true lender" is far from a technicality. Under a principle known as federal preemption, banks whose deposits are insured by the FDIC can lend at rates allowable in the state of the bank's location, which rates can then be exported to borrowers in other states and preempt conflicting state laws in states where borrowers are located.[355] This principle allows depository institutions to engage in nationwide lending under uniform terms rather than be subject to the rate and fee structure of the individual states where borrowers reside. A marketplace lender that works with a Funding Bank will in turn claim its own exemption from state lender licensing and usury laws on the basis that the Funding Bank (and not the platform itself) is the lender.[356] Claiming these exemptions has obvious benefits for the platform (*e.g.,* a consumer marketplace lender would thereby be able to offer its loans at uniform rates throughout the nation), but at the same time a marketplace lender that extends loans through a Funding Bank can face significant liabilities if the loans don't comply with federal and state requirements and it loses a true lender case. In fact, the enforceability of some or all of its loans may be called into question.[357] Potential consequences of the platform and not the Funding Bank being deemed the true lender include violation of state lending license laws and violation of state usury laws, which could result in a reduction or elimination of interest and/or principal and/or penalties or damages and, in some instances, voiding of the loan under state law. For this reason, true lender litigation is closely followed by market participants, and adverse rulings can have a significant impact on the marketability of loans extended by particular lenders and/or extended to borrowers in particular states.[358]

354 This type of litigation would not apply to lenders who make loans directly under state licenses at allowable rates and fees.

355 Federal preemption entitles national banks and FDIC-insured state banks to export the rates and fees of the state in which a bank is located to borrowers in other states and preempts inconsistent state laws in those other states. National banks are afforded preemption under 12 U.S.C. § 85 and state banks under 12 U.S.C. § 1831d. A Funding Bank may rely on federal preemption to extend loans at a higher interest rate than applicable state law might otherwise allow. As a result, Funding Banks tend to be located in states with no interest rate limitations, such as Utah or Delaware.

356 However, while avoiding lending licenses, platforms may in some states need licenses to solicit or broker loans to financial institutions, to purchase loans and/or to service and collect loans. This is discussed later in this book.

357 See "Lending Laws, Licensing, and Related Litigation" below for further discussion of the penalties that may apply to violations of state licensing or usury laws.

358 Many of the true lender cases that have been decided to date have involved payday lenders rather than marketplace lenders. In addition, some of the payday lender decisions have required the court to consider tribal law (which has been the governing law for certain payday loans but would not often be chosen to govern marketplace loans). The analysis of true lender issues undertaken in these cases is nonetheless instructive for marketplace lending structures, although different from notions of statutorily enumerated preemption powers.

> The largest regulatory focus remains the issue of determining the true lender, which is being addressed by litigation and state laws.

True lender theories also differ from litigation based on whether an assignee of a loan can enforce the loan terms as to borrowers. The latter theory challenges the "valid when made" doctrine that a loan which is valid when made by a lender can be enforced by a downstream purchaser of the loan, which is discussed later in this book.[359] The true lender theory challenges the validity of the named lender, asserting that someone other than the named lender is the lender in fact. While often asserted in the same proceeding, the two theories are different and distinct, although after the enactment of OCC and FDIC regulations codifying the valid-when-made doctrine, the focus appears to be shifting to true lender causes of action.[360]

Litigation continues to arise challenging third-party programs, particularly where banks fund high-rate loans or payday loans.[361] However, true lender litigation has also begun to expand further into the marketplace lending sector. The claims made in these cases assert that the payday loan marketers or marketplace lenders are actually the "true lenders," and that they are using banks as the named lender solely to evade compliance with state usury limitations, licensing regimes, and consumer protection laws imposed by the states where such payday loan marketers or marketplace lenders do business. Several earlier cases are summarized below.

***CashCall Decision—West Virginia.*** One of the first "true lender" cases is a 2014 decision from West Virginia where the Attorney General sued CashCall, Inc., the operator of an Internet loan program that used a South Dakota bank to fund consumer loans. CashCall was not licensed under West Virginia law and the loans made by the bank were made at interest rates in excess of the usury rate in West Virginia.[362] The state's position was that CashCall was the "true lender" under this arrangement because it had the predominant economic interest in the loans, and therefore CashCall should have followed

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359 The Second Circuit decision in the case of *Madden v. Midland Funding, Inc*. in 2015 ruled that an assignee of a loan could not enforce the rates charged by the assignor bank under certain circumstances. As discussed later, the OCC and the FDIC issued regulations that codified the "valid when made" doctrine that a loan valid when made remains valid when sold, transferred or assigned. The regulations withstood a court challenge and this point seems largely settled. However, the true lender theory goes to the issue of whether the loan itself is valid when made.

360 As detailed below, federal regulations state that a loan valid when made continues valid in the hands of an assignee when it is sold, transferred or assigned. Thus, the rates and fees allowed to be charged by a Funding Bank continue in the hands of an assignee.

361 Unrelated to litigation, we note that some websites such as Google now ban ads for loans with annual percentage rates of 36% or more.

362 CashCall was also sued by the State for debt collection practices. Interestingly, CashCall made inquiry to the State as to whether it needed to be licensed there and was told it did not need to be licensed. At trial, the State claimed that this response was based on CashCall's failure to adequately describe the program. The program worked in some respects like most third-party arrangements, with a marketing agreement in place where the bank kept origination fees and accrued interest on the loans until sold to CashCall soon after they were made. CashCall indemnified the bank, and its owners provided personal guarantees. Other facts, however, diverge from typical programs such as CashCall funding the loans.

applicable restrictions of West Virginia law, including its usury rate.[363] The court ruled in favor of the state, finding that CashCall was the de facto lender under this program. The court enjoined CashCall from making new loans in the state, voided the existing loans (thereby cancelling the debt of the borrowers), and awarded $1.5 million in civil penalties and $10 million in punitive damages against CashCall, in addition to attorneys' fees and costs. On appeal, the West Virginia Supreme Court upheld the decision.[364] CashCall sought review by the U.S. Supreme Court, but it declined to review this decision.[365] The decision in *CashCall* created some degree of uncertainty in the industry and spawned additional litigation surrounding the use of Funding Banks. Such suits are costly to defend.[366]

***Utah Case Supports Funding Bank as True Lender.*** In contrast to the *CashCall* decision, a federal court in Utah dismissed a consumer class action against an online payment processor, Bill Me Later, Inc., alleging that the originating bank was not the true lender in that arrangement.[367] The court stated in its decision that even accepting as true the allegation that the loans were designed to circumvent state usury laws more protective than Utah's, the case had to be dismissed because the claims were preempted by federal law.

The court based its decision in part on the fact that Bill Me Later, Inc., was a service provider to the bank. Under the provisions of the Bank Service Company Act, when a bank contracts with a third-party service provider for services, the performance of those services is "subject to examination and regulation" by the bank's regulator "to the same extent as if such services were being performed by the depository institution itself on its own premises."[368]

363 The court never defined what constitutes the "predominant economic interest," although this term has been used in other litigation.

364 *See CashCall v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 30, 2014). Although some see this case as an aberration primarily because of the excessive interest rates being charged, the legal principles involved are the same whether the rates are 1% or 100% above the applicable usury rate.

365 Typically, the Supreme Court hears less than 1% of those cases requested to be appealed.

366 A January 2016 federal court decision in *Commonwealth of Pennsylvania v. Think Finance, Inc.*, Case No. 14-cv-7139 (E.D. Pa. Jan. 14, 2016), demonstrates this point. A high-rate Internet payday lender utilized a Delaware state bank to make loans and then purchased the loans. The court denied a motion to dismiss on the basis of federal preemption, instead allowing the claims against the Internet payday lender to proceed on true lender theories. The case has since been settled.

367 *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359 (D. Utah 2014). Since many funding banks are located in Utah, this case may have particular precedential value.

368 Bank Service Company Act, 12 U.S.C. § 1867(c)(1). Based on coverage by this statute, the court found that loans serviced through contracts with third parties are included within applicable federal preemption and did not make the non-bank service provider the lender instead of the bank.

**Worth Remembering:** The Bank Service Company Act provides a potent defense to true lender allegations because it subjects bank service providers to regulatory scrutiny and accountability, providing both regulation and consumer protection. The court's opinion in *Bill Me Later* also provided some guidance for the proper structuring of lending arrangements between banks and third-party service providers, including that the bank (not the service provider) was the party to the loan agreement, the bank funded the loans and owned the accounts and held them for at least two days, and the bank received interest on the loans until they were sold.[369] Sale of a participation interest rather than the sale of a whole loan may also be beneficial. Some marketplace lenders using a Funding Bank have sought to replicate this structure to combat potential "true lender" claims.

***CashCall Decision—California.*** CashCall was again embroiled in litigation even after a change in strategy following the West Virginia litigation. In March 2014, the CFPB filed a lawsuit against CashCall in California.[370] The complaint alleged that CashCall ran a loan program using a "tribal model" whereby the loans were made by Western Sky, a Cheyenne River Sioux Tribe entity. All loans issued under this model were governed by tribal law, such that no state usury laws would apply. The CFPB alleged that this was an abusive practice where CashCall was the true lender, not Western Sky, and that the laws of the borrowers' home states should determine what usury law applies, despite the tribal choice-of-law provision contained in the loan documents.[371] The court ultimately sided with the CFPB, finding CashCall to be the "true lender" and holding that courts should look to the substance and not the form of the loan transaction. The court further noted that there was no substantial relationship between the loans and the Cheyenne River Sioux Tribe. As such, tribal law did not govern these loans.

369 *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359 (D. Utah 2014). In an earlier case, a court similarly placed greater emphasis on the bank's role as the named loan originator and held that preemption applied even though the website operator marketed and serviced the loans and had the predominant economic interest in the loans. *Hudson v. ACE Cash Express, Inc.*, No. IP 01-1336-C H/S, 2002 WL 1205060 (S.D. Ind. May 30, 2002). In that case, the court accepted as true the claims that a state-chartered bank played an insignificant role in a lending program that a non-bank had "designed for the sole purpose of circumventing Indiana usury law." But the court held that the bank was still the true lender based on federal law principles, noting that "concerns about protection of state usury laws present questions of legislative policy better addressed by Congress." In the *Hudson* case, the bank retained a 5% participation interest in the loan, while selling a 95% participation interest. The court determined that a participation does not destroy the debtor-creditor relationship and does not create privity between the loan participant and the borrower. Participations in loan have been common place for decades, although they have been related primarily to commercial loans. The legal principles related to participations are fairly well established as set forth in the *Hudson* case. As a result, one way to potentially avoid true lender claims is to have the Funding Bank sell participation interests in the loan, rather than sell the whole loan. The bank would retain the status of the creditor and also be able to thwart *Madden* claims as well since there is no assignee. However, not holding the entire loan could present potential issues in further selling or securitizing the asset.

370 *Consumer Fin. Prot. Bureau v. CashCall, Inc. et al.*, Case No. 15-cv-07522 (C.D. Cal. Aug. 31, 2016).

371 Additionally, the CFPB alleged that the debt-collection arm of the enterprise, Delbert Services, violated the law by collecting on accounts that did not have amounts due and owing. There are, of course, obvious differences between this case utilizing tribal law and marketplace loans. However, the case may help to define the parameters of a true lender analysis.

In December 2016, CashCall asked that the decision be certified for interlocutory appeal to the Ninth Circuit and in early January 2017, the court granted CashCall's request. One of the questions identified for review was whether the proper test for determining the true lender under a loan agreement allows the court to look past the documentation and its parties to investigate related transactions. Many in the industry were hopeful that the Ninth Circuit would hear the case because the decision could provide an important precedent in true lender litigation; however, the Ninth Circuit ultimately declined to hear the appeal.

Although the court found that CashCall was the true lender of certain loans it had marketed even though the loans were made by a Native American tribal entity and the loan agreements between the tribal entity and the borrower specified tribal law as the governing law. Those issues are different and distinguishable from those related to an FDIC insured Funding Bank, where there is statutory authorization for exportation of interest rates and preemption of federal loans.

The CFPB requested that the court void the CashCall loans and order restitution in the amount of almost $300 million to borrowers, but in January 2018 the court denied the CFPB's request and levied a fine of only $10 million against CashCall.[372] The CFPB had argued that restitution should be required because under various state laws, the loans were either void or carried excessive fees and/or interest. In denying the CFPB's request, the court found that the borrowers were not misled about the amounts they were required to pay for the loans and had received the loan funds and the benefit of their bargain.[373] The court's decision that the loans remained enforceable because their terms had been fully disclosed is significant because it shows that even when a true lender claim succeeds, the loans at issue will not necessarily be voided and reimbursement to borrowers may not be required depending on the facts. After stays enacted due to other pending litigation, the CFPB and CashCall both appealed the decision on damages to the Ninth Circuit Court of Appeals. The Ninth Circuit affirmed liability and then the district court awarded damages of $134 million, upheld by the Ninth Circuit in January 2025. CashCall has filed a petition with the U.S. Supreme Court to hear the case.

*California Case Finds That Funding Bank Is the True Lender.* Shortly after the California decision finding that CashCall was the true lender under its tribal model loan program, a judge in the same district issued a decision supporting the Funding Bank as the true lender for certain student loans.[374] In this case, class action plaintiffs that had obtained private student loans made by a national bank alleged that the "actual lenders" in the transactions were the companies that ended up buying and servicing the loans, in part because the national bank was required to sell all the student loans it made during the course of the program to these companies.

372 *Consumer Fin. Prot. Bureau v. CashCall, Inc. et al.,* Case No. 2:15-cv-07522 (C. D. Cal. Jan. 26, 2018).

373 *Id.* The court noted, "Defendants plainly and clearly disclosed the material terms of the loans to consumers—including fees and interest rates—before the loans were funded. Accordingly, the court cannot conclude that the defendants acted in bad faith, resorted to trickery or deception or have been guilty of fraud in connection with the origination of the loans that are at issue in this case."

374 *Beechum et al. v. Navient Sols., Inc. et al.*, No 15-cv-8239-JGB-KKx (C.D. Cal. Sept. 20, 2016).

> **Noteworthy:** The plaintiffs argued that the court should review the substance of the transaction rather than the form and find that these companies were not authorized to charge rates in excess of the California usury limit. The court declined to do so, explaining that while there are cases where courts have considered the substance of a transaction when assessing whether it satisfies the elements of usury or falls under a common-law exemption to the usury prohibition, that analysis does not apply when a transaction falls under a constitutional or statutory exemption to the usury limit.[375]

Interestingly, and perhaps the more salient point made, the court also took into account public policy considerations, noting that there are broader economic consequences in making it difficult for banks to assign or sell loans into the secondary market.

***LendingClub True Lender Class Action Settled in Arbitration.*** In April 2016, LendingClub was sued by borrowers in a class action for alleged violations of usury laws, RICO, and New York state consumer protection laws.[376] LendingClub originated loans through a state-chartered bank; the borrowers alleged that the loan program was a "pretext and a sham" and that the company was trying to avoid state usury laws by structuring its loan transactions through the bank. The plaintiffs relied on both *Madden* and true lender theories. Instead of answering the complaint, LendingClub moved to compel arbitration and stay the district court case pending that arbitration. On January 30, 2017, the court ruled in favor of LendingClub, granting the motion to compel arbitration.

The decision is significant because it finds that the arbitrator determines the question of whether the case is subject to arbitration or not. Under the Federal Arbitration Act, the decision is subject to immediate appeal to the Second Circuit. The decision is also significant because it compelled the arbitration on an individual—and not class—basis, potentially reducing the impact of any adverse decision. The court's ruling on LendingClub's motion to compel arbitration also provides support for the use of arbitration clauses in consumer loan agreements. Ultimately, the case was settled with a small settlement payment and no admission of liability or wrongdoing by LendingClub.[377]

### B. OCC True Lender Rule Invalidated

On July 20, 2020, the OCC published a rule defining who is the true lender on a loan.[378] In short, simple, and succinct fashion, the OCC stated that as of the date of loan origination the true lender is either the party named as lender on the loan agreement or the entity that funds the loan. The agency indicated that this rulemaking was being determined in the context of bank partnerships with third parties,

375 The ruling was based on a California statute limited to in-state banks and national banks. As such, the ruling may be narrow in scope. Had this action been against a non-national bank located out of state, a different result may have occurred.

376 *Bethune v. LendingClub Corp.*, No. 1:16-cv-02578 (S.D.N.Y. Apr. 6, 2016).

377 Confidential Settlement Agreement and General Release, *Bethune v. LendingClub Corp.*, No. 1:16-cv-02578 (filed Mar. 2, 2018).

378 85 Fed. Reg. 44223 (July 20, 2020), to have been codified as 12 C.F.R. pt. 7.1031.

including marketplace lending. The OCC emphasized the piecemeal and divergent court decisions on the subject, which are neither clear nor dispositive, have created uncertainty and discouraged third-party lending relationships and limited competition. The OCC emphasized the need for predictable and stable markets that will allow for the continued availability of credit.[379] The proposal was subject to a public comment period that ended September 3, 2020, and a final rule was published in the Federal Register on October 30, 2020.[380] The OCC issued the final rule that ostensibly became effective in December; however, the rule was invalidated under the Congressional Review Act, which gives Congress the power to overrule agency rulemaking.[381] On June 30, 2021, the President signed a joint resolution of Congress to disapprove the OCC true lender rule. As a result, it is as if the rule had never been put into effect and, in addition, a new rule that is substantially the same cannot be enacted unless authorized by a law passed by Congress.[382]

## C. True Lender Litigation in Colorado

### *1. Background on the Colorado True Lender Litigation*

The Colorado Attorney General serves as the Administrator of the state's Uniform Consumer Credit Code (*"UCCC"*), the statute that governs extensions of consumer credit to Colorado residents.[383] Colorado's version of the UCCC contains an "extraterritoriality" provision which purports to apply the UCCC to any consumer credit transaction with a Colorado resident, even those made by out-of-state lenders, and prohibits the parties from choosing any law to govern the transaction other than that of Colorado. The UCCC also limits allowable interest rates and fees that may be charged in consumer credit transactions.

In early 2017, the Administrator brought legal actions against two marketplace lenders that are licensees under the UCCC. In Colorado, licensing is required to take assignment of and service consumer loans. Since both platforms purchased and serviced loans, they became licensed. As licensees, they were subject to examination by the Colorado Administrator. The targeted marketplace lenders were sued when they did not correct deficiencies cited by the Administrator for charging and collecting interest rates and fees to Colorado borrowers above those allowed by the UCCC and not having a Colorado

379 The OCC correctly notes that divergent standards have emerged in true lender cases and that there is no predictable standard, as different factors are considered and not given the same weight, result in subjective determinations, and undermine the certainty and stability needed in financial markets.

380 85 Fed. Reg. 68742 (Oct. 30, 2020). The FDIC never promulgated a similar rule.

381 *See* 5 U.S.C. § 801. The House passed its joint resolution on June 24, 2021, and the Senate on May 11, 2021.

382 The meaning of the repeal is open to debate. Most likely the result is a return to the status quo prior to the rule being proposed, which means that the conflicting and ambiguous standards from court decisions will be used as guidance for future true lender determinations. Hence, the risk for marketplace lenders should not appreciably change.

383 The significance of the Colorado litigation is heightened by the fact that a number of states have enacted similar versions of the UCCC which could be impacted by the decision. Those states include Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming.

choice-of-law provision governing the loan agreement.[384] At the heart of the complaints were allegations that the marketplace lenders were the "true lenders" on the loans to Colorado residents because of how their arrangements were structured and because they held the predominant economic interest in the loans.[385]

### *2. Procedural Posturing: Removal and Remand*

Soon after the Administrator filed the suits in state court in Denver, both platforms removed the cases to federal court, claiming that the actions were completely preempted by federal law, specifically the Federal Deposit Insurance Act, because the loans at issue were made by FDIC-insured banks.[386] The Administrator filed motions to remand (*i.e.,* to send back) both cases to state court.[387] In March 2018, the federal court in Colorado hearing both actions determined that the federal court did not have jurisdiction of the matter and, in fact, remanded both cases back to state court. The basis of the decisions was that the complaints on their face did not raise a federal question despite the claims of the marketplace lenders that the loans were made by a federally insured bank and federal law completely preempted the Administrator's claims. The determination was made in large part because the Administrator made no direct claims against either of the Funding Banks. The decisions to remand are procedural in nature and while the cases proceeded in state court, rather than federal court, the platforms could still pursue their federal preemption arguments in the state court actions.[388]

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384 The actions were titled *Fulford et al. vs. Marlette Funding, LLC et al.*, No. 2017-cv-30376 (Dist. Denver Cty.), and *Fulford et al. vs. Avant of Colorado, LLC et al.,* No. 2017-cv-30377 (Dist. Denver Cty.).

385 As to structuring, the Administrator alleged that the platforms pay implementation fees to start the programs, pay the Funding Banks' legal fees, bear the costs of marketing the program and evaluating loan applications, are responsible for ensuring compliance with applicable laws and assume responsibility for the servicing and administration of the loans even before they have purchased the loans from the Funding Banks. The Administrator also alleged that the marketplace lenders assume all risk of default and indemnify the Funding Banks for claims arising from the lending programs. Because the bank only holds the loan for a short period of time, the allegations also claim the platforms to be the true lender because they hold the predominant economic interest in the loans. Taken at face value, the predominant economic interest theory would potentially hold any purchaser of any loan from a bank at risk for these types of claims, impeding the ability of banks to obtain liquidity by selling loans in the secondary market, a practice that most financial institutions have engaged in for decades. The facts raised in the lawsuit would seemingly be more difficult to assert in a situation utilizing a loan participation structure rather than a loan sale. Participations have long been used by banks. In a participation, the originating bank continues to hold title to the loan and account relationship but sells percentages of the economic benefits and risk in the loan to others. This provides liquidity to the bank. Borrowers are usually not aware that participations have been made in their loans. Since the bank retains title to the loan throughout its life, it would be more difficult to assert that the bank is not the true lender. This would be even more difficult in the case of open-end credit, such as credit cards where the originating bank continues to hold the account and makes future advances on the account.

386 Certain state court actions may be removed to federal court within 30 days under 28 U.S.C. § 1446. In this case, the platforms believed that the action raised a federal question, allowing for removal pursuant to 28 U.S.C. § 1331. In the initial complaint, the Administrator's allegations did not mention the fact that the loans at issue were made by FDIC-insured state banks, possibly in an attempt to avoid removal to federal court.

387 The procedure for remanding a case back to state court is found in 28 U.S.C. § 1447.

388 *See Meade v. Avant of Colorado LLC d/b/a Avant and Avant, Inc.*, No. 17-cv-0620, 2018 WL 1101672 (D. Colo. Mar. 1, 2018) and *Meade v. Marlette Funding LLC d/b/a Best Egg*, No. 17-cv-00575, 2018 WL 1417706 (D. Colo. Mar. 12, 2018).

The Colorado actions were litigating primarily procedural matters for more than two years. The parties engaged in discovery and several motions were filed and pending, so any court resolution would not happen quickly. The settlement also avoids what was sure to have been a lengthy appeals process.

### *3. Banks File Declaratory Judgment Actions in Federal Court*

The two Funding Banks making the loans that were subject of the Administrator's lawsuits each filed a declaratory judgment action in Colorado federal court.[389] The Funding Banks asked the court to declare that the loans at issue were validly made by a federally insured depository institution and therefore, under the federal preemption doctrine, the permissible rates and fees on any loans made by the banks to Colorado residents were governed by the laws of the Funding Banks' home states and not by the laws of Colorado. Several trade groups filed briefs in these actions.[390] The Funding Banks also sought to enjoin the Administrator from taking further action against the two marketplace lenders. The Administrator in each action filed a motion to dismiss, claiming that the banks lacked standing to bring the suit. In March 2018, about a year after the actions were filed, the federal court dismissed both actions based on the legal doctrine of abstention. Under this doctrine, federal courts will not interfere with state court proceedings that can deal with the subject matter of the claims and, as a result, must abstain from exercising federal jurisdiction. One of the cases was appealed to the Tenth Circuit Court of Appeals, but the appeal was subsequently dismissed.

Colorado also filed suit to implicate investors and securitization trusts in its litigation on true lender theories.

### *4. Colorado Sues Securitization Trusts*

Both marketplace lenders filed motions to dismiss the Colorado action, which the court denied in the summer of 2018. However, both banks were given the right to intervene and participate in the actions, and each bank joined its respective case.

On November 30, 2018, the Administrator filed a Second Amended Complaint containing allegations similar to those in the prior complaint, but naming as additional defendants the trustees of certain securitization trusts and certain special purpose vehicles that acquired loans originated through the

389 *See WebBank v. Meade*, Civil Action Case No. 17-cv-00786-PAB-MLC (D. Colo. filed Mar. 28, 2017) (Funding Bank for the Avant platform) and *Cross River Bank v. Meade,* Civil Action Case No. 17-cv-00832-PAB-KMT (D. Colo. filed Apr. 3, 2017) (Funding Bank for the Marlette/Best Egg platform).

390 These included the Independent Community Bankers of America, New Jersey Bankers Association, The Clearing House Association L.L.C., American Bankers Association, Loan Syndications and Trading Association and The Marketplace Lending Association.

platforms to borrowers who were residents of Colorado at the time of their loan applications.[391] The Administrator claimed that the trusts meet the definition of a creditor under the UCCC and were receiving compensation greater than that allowed by the UCCC, and therefore have the predominant economic interest in the loans. The newly named defendants filed motions to dismiss on the grounds that the Colorado state court lacks personal jurisdiction over them. On February 20, 2019, the Administrator responded in opposition to the motions. After briefing on the motions, in May 2019 the Colorado court denied the motions to dismiss, finding that it could exercise jurisdiction over the securitization trusts and that, by receiving payments, the trust could be considered to be a creditor under the UCCC.

Motions for summary judgment were filed by each side in both cases and the state filed a "Motion for Determination of Law" asking the court to determine, if in fact the banks were found to be the true lender for the loans made to Colorado residents, whether the rates and fees charged by the banks could be enforced by non-bank assignees of the loans. In June 2020, the court answered in the negative. It found that even if the banks were the true lenders on the loans, that the platforms, as assignees of the loans, could not as a non-bank entity, take advantage of the federal preemption that the banks enjoyed and stand in the shoes of the banks with respect to the loan terms. Thus the platforms, as assignees, could not charge the rates and fees that the banks were allowed to charge, according to the court.[392]

#### *5. The August 2020 Settlement*

On August 18, 2020, the parties to the litigation agreed to settle the matter. The implications of the settlement should allow platforms to work with Funding Banks to make loans to Colorado residents so long as loans do not exceed a maximum 36% APR. While the settlement relates only to the parties involved in the litigation and extends to all programs of the two Funding Banks involved, the implication is that other bank programs that follow the parameters of the settlement should be entitled to the same deference.

***Maximum Rate and State Licensing.*** There are several requirements that comprise the settlement. First, loans to Colorado residents must not exceed a maximum APR of 36%. This was the maximum being charged by one of the banks in the lawsuit (the other limited loans to 30% APR) but is greater than the 21% maximum rate specified in the Colorado UCCC. Second, any platform that takes assignment of loans or receivables in any manner and engages in direct collection or enforcement of those loans must become licensed as a supervised lender under the Colorado UCCC.[393] This will allow

391 The trustees were sued in their fiduciary capacity as a trustee, and not in their individual capacity.

392 This decision was made within the contours of this particular case, so it may not have true precedential value. However, it is anticipated that similar claims in other litigation will cite this decision for support. The decision also came at the same time as federal banking regulators issued regulations contrary to the court's decision. No doubt the alignment of both actions made it advantageous for both sides to enter into a settlement.

393 There will be additional reporting requirements for loans carrying an APR in excess of 21%.

the state to monitor and supervise the non-bank that is involved with the financial institution and, thereby, the entire program. Third, loan programs must meet certain operational and compliance standards. The programs must be subject to federal or state oversight. The bank must control the program and review, approve and oversee (with audit rights) origination activities, marketing materials, website content, credit terms and credit models, and it must approve or deny all applicants. The bank must be the named lender on loan documents, fund the loans from its own funds, and approve third-party subcontractors. The platforms must have a compliance management system, including a system for tracking and resolving complaints. The parties must comply with applicable regulatory guidance for third-party arrangements, and be subject to audit and corrective action.[394]

***Banks Must Have "Skin in the Game."*** One goal of the state was to see that the banks had an economic stake in the loans. For the loans that exceed Colorado usury limits of 21%, which the settlement called "Specified Loans," there are three options to ensure that the lending banks have "skin in the game" as to the sale of those loans. There are no limitations generally placed on loans with an APR up to 21%. The following three options outlined by the settlement deal with the sale of the Specified Loans and arguably provide a "safe harbor" for sale of loans to non-banks.

- ***Option 1: Uncommitted Forward Flow Arrangements.*** Under this option, there is no commitment by the platform to purchase the Specified Loans from the bank. The bank will provide a notice of loans it wants the platform to purchase, but the platform is under no obligation to purchase all of the loans in the notice and only needs to purchase those loans it specifies. The bank may retain, sell, or securitize loans that the platform does not choose to purchase. Under this option, indemnification by the platform to the bank can only cover services not performed by the platform to the bank but not for either the performance of the loans or any failure to purchase loans offered (unless a commitment has been made to purchase the loans). The program can be collateralized, but not for Specified Loans, unless there has been a commitment to purchase those loans, and then only up to certain limits.

- ***Option 2: Maximum Transfer of Specified Loans in Forward Flow Commitment.*** Under this option, the bank can transfer up to 49% of the economic interest in the Specified Loans in a committed forward flow arrangement or sell 25% of the Specified Loans on a committed basis, with the rest being on an uncommitted basis. This includes whole loans, participations or sale of receivables. There would be no restrictions on collateral or indemnification on committed loans. The banks may also sell loans to others, including to securitizations.

- ***Option 3: Program Loans.*** Under this option, the banks can sell 85% of all program loans to the platform, but no more than 35% can be Specified Loans.

394 The two banks involved in the litigation generally adhere to these requirements.

*Other Provisions of the Settlement.* The settlement provides for the payment of certain monetary amounts to the Administrator and to a fund for economic literacy education. There is no admission of liability on behalf of the defendants.[395]

The settlement also provides for a "safe harbor" for the litigants. The state will not pursue claims, past or future, for violations of Colorado law based on matters of federal preemption of state law or true lender theories or related to the assignment of the loans. In addition, all other programs of the litigating lending banks that comply with the terms of the settlement will be subject to the safe harbor. The court will dismiss the litigation with prejudice; any administrative actions pending will be withdrawn and any expired licenses will be renewed.

The terms of the settlement apply for five years, until 2025, but a conflicting change of law or regulation could reduce this period to two years. Actions in other states could reduce the 36% APR cap in certain circumstances. In addition, certain loan modifications and forbearances will be made to Colorado borrowers in respect of the pandemic.

*Significance of the Settlement.* The settlement of these two cases is significant for several reasons.

First, this is a scenario in which a state regulator was challenging the bank funding model widely used in the marketplace lending industry. If these challenges had proved successful, other states would likely follow.

Second, if the actions were successful, the penalties could have been severe. Violations of the Colorado UCCC result in voiding of the finance charge, a possible penalty (as determined by the court) of up to three times the finance charge, the recovery of excess charges and a separate penalty equal to the greater of the finance charge or ten times the excess charge plus attorneys' fees.[396]

Third, since several states have enacted various forms of the UCCC, a decision in favor of the Administrator could have spawned actions in those other UCCC states and in other states as well.

Fourth, the addition of purchasers of loans as defendants is attempting to subject financing vehicles and investors to the ambit of the UCCC and its attendant penalties could have inhibited investment in marketplace loans. The litigation itself had already spawned significant impacts on the financing of loans made through online platforms in Colorado.[397] But the August 2020 settlement has likely changed this.

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395 $1,050,000 will be paid to the State of Colorado for consumer protection efforts and $500,000 in contributions will be made to a fund for financial education programs.

396 The statute does state, however, that no violation impairs the right to collect the underlying principal amount of the debt.

397 Some lenders, loan purchasers and securitizations have either excluded or limited the amount of Colorado-based loans included in a borrowing base, determination of eligible receivables or securitization loan pool. This has the effect of limiting the amount of credit ultimately available to borrowers in Colorado.

The settlement provided a sigh of relief for the marketplace lending industry, which had been watching this litigation with interest. Protracted litigation and imminent appeals—which would have resulted in prolonged uncertainty in the industry—have now been avoided in Colorado at least in the short term. Colorado's recent attempt to opt out of federal preemption could also affect this settlement.

The terms of the settlement are consistent with most mainstream marketplace lending programs, although some re-structuring may be necessary in terms of the purchase of Specified Loans. But marketplace lending will again be alive and well in Colorado, at least for loans up to 36%, ending a drought created when many platforms avoided Colorado due to this litigation. This will increase the access to credit for Colorado residents.

The fate of other programs remains in some doubt. However, it would seem that programs that adhere to the parameters of the settlement should not come into the Administrator's sights, particularly when these might be addressed as part of the licensing process that would be required, although high rate programs would still remain on the radar screen of the Administrator and subject to the types of claims brought in this litigation.

This settlement may serve to chill efforts of other state regulators on similar marketplace lending issues or serve as a basis for similar settlements in other jurisdictions. But because this settlement is limited to Colorado, its ultimate effect may be limited. It may also serve as impetus for renewed discussion of the imposition of a national usury rate.

However, states may face a more difficult time pursuing claims against marketplace lending platforms due to the recent actions of federal banking regulators codifying as federal regulations that the interest rates made on a loan originated by a federally insured bank at inception do not change when the loan is sold or assigned.

The settlement should provide a level of certainty and comfort for investors in Colorado-based marketplace loans and for the securitization of Colorado loans. In any event, this settlement in Colorado is a significant development in the marketplace lending arena.

### D. Other Cases

***Small Business Marketplace Lender Sued in Massachusetts.*** In October 2017, a small business owner filed suit against a small business marketplace lender and its Funding Bank in federal court in Massachusetts.[398] As in other true lender cases, the main allegation was that the marketplace lender used the Funding Bank's charter to originate loans that were usurious under state law and that the marketplace lender was the true lender because it bore the risk of loss for the loans. However, this Massachusetts case is noteworthy for several additional reasons. First, it was brought against a small

398 *NRO Boston, LLC and Alice Indelicato v. Kabbage, Inc. and Celtic Bank Corp.,* Case 1:17-cv-11976 (D. Mass. filed Oct. 12, 2017).

business marketplace lender rather than a consumer lender. Second, the suit also named the Funding Bank as a defendant rather than omitting the Funding Bank like the Colorado Administrator in the cases described above. And third, it alleged violations of federal marketing and racketeering laws. Specifically, the plaintiff asserted causes of action under the Lanham Act[399] for false advertising and under the federal Racketeer Influenced and Corrupt Organizations Act *("RICO")*[400] for conspiring to violate usury and consumer protection laws. The RICO cause of action is attractive for plaintiff lawyers as it provides for treble damages and the potential recovery of attorneys' fees and costs.

The marketplace lender's loan agreement contained an arbitration provision and the defendants filed a motion to compel arbitration, which was opposed. However, on March 16, 2018, the court entered an order staying the proceedings pending the outcome of arbitration. As we've seen in other cases,[401] the fact that the loan agreement contained an arbitration clause proved helpful in sending the case to arbitration rather than proceeding in court. After a five-day arbitration was held the arbitrator rejected the true lender theories, found the bank to be the true lender and the commercial note valid and entered an over $3 million judgment in favor of the bank. In a somewhat bizarre pattern of events, the plaintiff filed an entirely new lawsuit based on the same facts while the defendants filed to enforce the arbitration awards. The action ended with an acknowledgment of the debt, payment and dismissal.

In another case, on March 22, 2018, a small business owner filed a putative class action lawsuit against the same marketplace lender and bank in state court in California. On April 24, 2018, defendants removed the case to federal court.[402] The complaint alleges that Kabbage's partnership with Utah bank Celtic Bank is a "rent-a-bank" scheme the purpose of which was to evade criminal usury laws. The suit asserts violation of California usury and consumer protection laws for false advertising and unfair competition, and violations of federal RICO laws. The defendants moved to compel arbitration based on a provision in the loan agreement, and the action was stayed pending the outcome of arbitration. In December 2018, the case was dismissed.

Yet another complaint was filed in federal court in New York in October 2019 against the same marketplace lender and two of its principals, seeking to represent a class of merchant borrowers in California, Colorado, Massachusetts and New York.[403] The claims in this suit are also based on true lender theories. Kabbage filed a motion to compel arbitration; however, before the motion was ruled upon the case was dismissed voluntarily by the plaintiff without the ability to bring the suit again.

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399 15 U.S.C. § 1125(a).

400 18 U.S.C. § 1962.

401 *See, e.g., Bethune v. LendingClub Corp.*, No. 16-cv-02578 (S.D.N.Y. Apr. 6, 2016), which is discussed further under "Issues Related to the Funding Bank Structure."

402 *Barnabas Clothing, Inc. et al. v. Kabbage, Inc. & Celtic Bank Corp.* (C.D. Cal.) (No. 2:18-cv-03414).

403 *Bright Kids NYC, Inc. et al. v. Kabbage, Inc. et al.* (No. 19 Civ. 9221 S.D.N.Y.).

On June 23, 2021, a borrower of a Best Egg loan filed a putative class action complaint against Marlette Funding, LLC in state court in Pennsylvania.[404] Marlette subsequently removed the case to federal district court and filed a motion to compel arbitration of the plaintiff's claims.[405] The plaintiff alleged Marlette was the lender of the loan rather than Cross River Bank and that, based on the *Madden* case, Marlette may not rely on the federal preemption of interest rate laws that applies to Cross River Bank after the sale of the loan. A motion to compel arbitration was filed. On January 16, 2023, the plaintiff filed a voluntary notice of settlement. The court dismissed the litigation by stipulation on January 30, 2023.

> The use of arbitration agreements has been successful in obtaining dismissals of purported class action lawsuits.

On July 23, 2021, a consumer filed a putative class action complaint against a non-bank partner that arranged for the origination of loans by WebBank in state court in Pennsylvania.[406] The plaintiff alleged both that the non-bank partner was the lender of the loan rather than WebBank and that, based on the *Madden* case, the non-bank partner may not rely on the federal preemption of interest rate laws that applies to WebBank after the sale of the loan. Based on these theories, the plaintiff claimed that the interest rate on the loan exceeded the 6% interest allowed by Pennsylvania law. The complaint raised a claim under the Pennsylvania Loan Interest Protection Law, the Consumer Discount Company Act, and the Unfair Trade Practices and Consumer Protection Law on behalf of a putative class of Pennsylvania borrowers who paid interest and fees in excess of 6% simple per year, and it seeks actual, statutory, treble and other damages, attorneys' fees and costs, declaratory relief, and other unspecified relief. On August 26, 2021, Avant removed the case to federal court. The court denied plaintiff's motion to remand. On September 23, 2022, the Magistrate Judge issued a report and recommendation to grant Avant's motion to compel arbitration. On November 10, 2022, the federal court granted Avant's motion to compel arbitration and dismissed the case.

In addition, two borrowers commenced putative class actions in the circuit court for Montgomery County, Maryland, against a marketplace lending platform and certain entities that had been trying to collect on the borrowers' loans. The complaint asserts claims for violation of certain Maryland state laws and seeks damages in part on the theory that the platform is the true lender rather than WebBank. The plaintiffs also seek a declaration of requirement for Maryland licensure as a credit services business and alleged that certain defendants did not have the right to collect money from the plaintiffs and the class members on the loan accounts. Defendants removed the actions to federal court and have moved to

404 *Henry v. Marlette Funding, LLC*, No. GD-21-007229 (Ct. Common Pleas, Allegheny Cty., Pa.).

405 *Henry v. Marlette Funding, LLC*, No. 2:21-cv-00985 (W.D. Pa.).

406 *McDaid v. Avant, LLC*, No. GD-21-008447 (Ct. Common Pleas, Allegheny Cty., Pa.).

compel arbitration.[407] Plaintiffs also filed a separate proceeding claiming that the arbitration provisions are unenforceable, which defendants also removed to federal court.[408] The district court consolidated the cases and ruled in favor of the defendants, granting the motion to compel arbitration. The plaintiffs both moved to reconsider and appealed. On April 4, 2023, the motion for reconsideration was denied and on April 10, 2023, the appeal was docketed at the Fourth Circuit Court of Appeals.

On June 1, 2022, a putative class action lawsuit was filed in federal court in the Western District of Texas, alleging that persons received high interest rate loans through Opportunity Financial that exceeded the usury limits in violation of Texas usury laws. The suit asserted statutory claims under Texas law, claims of unjust enrichment, and violation of the federal Racketeer Influenced and Corrupt Organizations Act and also sought a declaratory judgment that the loans are unconscionable, void and unenforceable.[409] The suit alleged that Opportunity Financial was the true lender with the predominant economic interest in the loans; that the originating bank, FinWise Bank, was not the real party in interest to the loans; and that Opportunity Financial had devised a "rent-a-bank scheme" in an attempt to evade Texas law. The complaint alleged that the interest rate on the loans in question was 130% and thus in excess of the 30% usury limit in Texas. The complaint further asserted that the loan's arbitration clause is unconscionable, void and unenforceable. Opportunity Financial filed a motion to compel arbitration. In January 2023, the motion to compel arbitration was granted and the case was dismissed.

A purported class action complaint was filed at the end of 2021 in California, alleging various claims against a marketplace lending participant.[410] Although the facts alleged a true lender scenario, rather than making typical claims of true lender or usury, the complaint sought relief for state law causes of action related to unfair competition, unconscionability, money had and received, and conspiracy and fraudulent concealment. This strategy may have been to avoid raising issues or defenses related to federal preemption of state law. A motion to compel arbitration was denied on March 29, 2023. In March 2023, the court denied the motion and a motion to reconsideration was filed. Ultimately, the Ninth Circuit remanded the case to compel arbitration.[411]

These recent cases denote the utilization of arbitration clauses, raising the ability of defendants in most instances to plead that the actions should be arbitrated, which generally moots class claims.

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407 *Jones v. Prosper Marketplace, Inc.*, Case No. 8:21-cv-00893-GJH (D. Md.); *Khan v. Crown Asset Mgmt., LLC*, Civil Action Case No. 8:21-cv-01126-GJH (D. Md.).

408 *Khan et al. v. Crown Asset Mgmt., LLC et al.*, Case No. 8:21-cv-01914 (D. Md. filed July 29, 2021).

409 *Michael v. Opportunity Fin., LLC*, Case No. 1:22-cv-00529 (W.D. Tex. June 1, 2022).

410 *Crystal Carpenter et al. v. Opportunity Fin., LLC*, Case No. 2:21-cv-09875 (C.D. Cal. filed Dec. 22, 2021).

411 California has some unique issues related to arbitration due to case law there (discussed elsewhere in this publication). Ninth Circuit Case No. 23-55553 (dec. Mar. 21, 2024).

### E. True Lender Case Resolved in Massachusetts

In 2017, an action was filed against an online business lender and its Funding Bank.[412] The basis of the allegations was that the non-bank was the true lender of the loan. Based upon an arbitration provision in the loan agreement, the matter was sent to arbitration where a five-day arbitration commenced. The arbitrator gave no credence to the allegations that the non-bank was the true lender and awarded a judgment in favor of the bank for over $3 million. While the bank moved to enforce the arbitration award, the original plaintiff brought another action in federal court again raising true lender claims.[413]

In May 2020, both actions were settled and dismissed by granting the bank's motion to confirm the arbitration award in the amount of $3,299,621.97, which court filings indicate was satisfied. The use of an arbitration clause appeared to be helpful to the cause of the lender and fintech involved in the lending program.

### F. Pennsylvania *Think Finance* Litigation

***Investors Sued.*** The *Think Finance* litigation started in 2014 when the Pennsylvania Attorney General brought an action against an Internet payday lender who first used a Funding Bank, and then later a Native American tribe, to extend loans to Pennsylvania residents.[414] Think Finance initially sought to have the case dismissed on the basis of federal preemption, but in January 2016, the court denied this motion and allowed the Attorney General's claims to proceed on a true lender theory. Subsequently, Think Finance filed for bankruptcy protection. The Attorney General then filed an amended complaint, adding as defendants certain investors who were providing funding to Think Finance. The investors filed a motion to dismiss the claims as they related to Think Finance's Funding Bank program. On January 26, 2018, the court dismissed the claims made against the investors under Pennsylvania's Corrupt Organizations Act (a state statute similar to the federal RICO laws), finding that an investor who merely funds an alleged unlawful enterprise would not have liability under that Act absent allegations that the investor had knowledge of being a part of an unlawful activity, which the Attorney General had not pled. However, the investors remained subject to claims for their participation in Think Finance's tribal lending program.

Think Finance declared bankruptcy and as part of a global settlement of several pieces of litigation, the Pennsylvania Attorney General reached a settlement as part of the bankruptcy proceeding that forgave outstanding loan balances and submitted $2 million to the state for customer refunds. Funding of the settlement included participation of the major investor of the company.[415]

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412 *NRO Boston LLC and Indelicato v. Kabbage, Inc. and Celtic Bank Corp.*, Civ. Act. No. 1:17-cv-11976-GAO (D. Mass.).

413 *NRO Boston, LLC et al. v. Kabbage, Inc. et al.,* Civ. Act No. 1:19-cv-11901 (D. Mass.).

414 *Commonwealth of Pennsylvania v. Think Finance, Inc. et al.*, Civil Action Case No. 14-cv-7139 (E.D. Pa).

415 The bankruptcy was in the Northern District of Texas. *In re Think Finance LLC et al.*, Case No. 17-33964. The overall settlement also included settlement of claims brought by the CFPB against Think Finance. It obtained a mere $7 recovery ($1 for each of seven companies) in order to maximize recovery to borrowers. The CFPB action, like the Pennsylvania action, alleged

> **Caution:** This case suggests that investors should proceed with some caution when dealing with higher-risk programs such as those involving high rate payday loans or tribal law, particularly if the investors are involved in decisions affecting the operations of the loan program.

*Action in North Carolina.* In another action involving the Think Finance tribal lending program, a lawsuit was filed in federal court in North Carolina.[416] Similar to the approach taken by the Pennsylvania Attorney General after Think Finance filed for bankruptcy, the plaintiffs in this case brought claims against various persons associated with the tribal lending program, including lenders, investors and even banks which processed ACH transactions for the program, since (because of the Think Finance bankruptcy) it was unable to sue Think Finance itself. Interestingly, the complaint states that the rates charged under the tribal lending program actually violated usury provisions of the tribal law that purportedly governed the program. The complaint also alleges violations of the Electronic Funds Transfer Act, the Federal Trade Commission Act and RICO. Specifically, it was alleged that collection of an unlawful debt alone violates RICO. The remedies sought include voiding of the loans including the governing law, forum selection and arbitration provisions of the loan agreements, disgorgement of profits, treble damages, an injunction and attorneys' fees and costs. The case was stayed pending settlement.

> **"True Lender" Takeaways:** Two points can be taken from these true lender cases. First, it appears that claims under RICO are becoming more common, likely due to the potential for treble damage recovery. Second, while most of these cases are still being brought against payday lenders and tribal lending programs, the range of defendants is being expanded to include Funding Banks, investors, marketplace lenders and, as in the North Carolina case, banks providing services to the program such as ACH processing.[417] It appears likely that true lender litigation will continue to create uncertainty and risk in the marketplace lending space.

claims of avoiding state licensing laws and exceeding state usury limits. Think Finance did not admit any liability and maintained that it was acting as a technology service provider for valid lending relationships.

416 *Granger et al. v. Great Plains Lending LLC et al.*, No: 1:18-cv-00112 (M.D.N.C.).

417 Cases involving payday lenders and/or tribal programs will often raise different issues and considerations than would apply to claims brought against marketplace lenders, assuming that the marketplace lenders extend their loans at interest rates significantly lower than payday rates and partner with Funding Banks under arrangements intended to ensure that federal preemption applies. As part of their defense against true lender claims, marketplace lenders should also be able to assert reliance upon common law "valid when made" and assignment principles, although these principles have been called into question by the *Madden* decision as discussed further in this book under "Usury Law."

### G. D.C. Files True Lender Action

***DC Attorney General Settlements.*** The Attorney General in the District of Columbia brought two actions against online lending programs, resulting in settlement in both instances. In 2020, the Attorney General filed a complaint in the District of Columbia Superior Court alleging that a company deceptively marketed loans to consumers with rates into the triple digits, far in excess of the DC usury rate of 24%, and was a sham "rent-a-bank" arrangement.[418] The company removed the action to federal court on the basis that under federal law, the district's usury caps would be preempted for the out-of-state bank that made the loans marketed by the company.[419] In a lengthy opinion, the federal court remanded the action back to state court. The court's reasoning indicated that while preemption applies to banks—not non-bank entities—and the complaint alleged a cause of action, the company was the true lender and the claims are factual, not legal, in nature, which was within the ambit of the Superior Court to decide. Ultimately, in February 2022, the parties settled the action by the online platform agreeing to pay some $3.8 million and comply with the District's interest rate limitation.[420] This settlement followed another settlement with another online lending program sponsor in November 2021.[421] This entity paid some $1.5 million to settle claims of predatory lending as being the true lender on loans made to District of Columbia borrowers.[422]

> Litigation has centered on higher rate loan programs when challenging federal preemption under a true lender theory. Some complaints avoid naming banks as a strategy to avoid the bank raising the defense of federal preemption.

***Massachusetts Student Loan Case.*** An April 2021 decision from Massachusetts found that a bank was the true lender on a loan that was subsequently transferred to a trust comprised of student loans.[423] The bank service provider designed and marketed a student loan program where the student loans were funded by a national bank and subsequently sold to a trust established by the service provider. The plaintiffs, a borrower and co-signer of a student loan, sued the trust primarily on the allegation that the loan exceeded the 6% usury rate set by Pennsylvania law and that the service provider and not the bank was the true lender on the loan. The plaintiffs sued 13 trusts originally. The defendant filed a motion to dismiss the action. The court dismissed the action against 12 of the trusts, as the loan was

418 *District of Columbia v. Elevate Credit, Inc.*, Case No. 2020 CA 002697 (Sup. Ct. D.C.).

419 *District of Columbia v. Elevate Credit, Inc.,* Civ. Action No. 20-1809 (EGS) (Dist. D.C.).

420 $3.3 million was for alleged overcharges of interest to District borrowers. Some $300,000 of interest is waived, and it made a $450,000 payment to the District.

421 *District of Columbia v. Opportunity Fin., LLC*, 2021 CA 001072B.

422 The Consent Judgment and Order provided for reimbursement of excess interest, waiver of other interest, and payment of a $250,000 fine.

423 *Robinson and Spears v. Nat'l Collegiate Student Loan Trust 2006-2*, 2021 WL 1293707 (D. Mass. Apr. 7, 2021), on appeal to the First Circuit Court of Appeals.

not a part of those trusts, but considered the allegations as they related to the one trust into which the plaintiffs' loan was sold. The court dismissed the action against the trust.[424]

The court upheld the concept of "valid when made" and found the bank to be the true lender on the loan. The court found that Section 85 of the National Bank Act preempts conflicting state law and that national banks have the power to purchase and sell loans (citing 12 C.F.R. pt. 7.4008(a)). The court ruled that the interest rate on the original loan was non-usurious and therefore could not become usurious upon assignment. The court gave deference to the OCC's recently enacted "valid when made" regulation. As to the true lender theory, the court stated that the plaintiffs had not identified any binding authority that would require the court to apply the true lender doctrine.[425] In addition, the court looked to the transaction documents, finding that the national bank was the named lender on the loan, funded the loan, and could be required to hold the loan for an extended period of time. The court did not deem it necessary to address the OCC's true lender rule that is being challenged in court and in Congress. Therefore, the court concluded that the bank did have economic risk as to the loan. The court also dismissed state law claims related to breach of contract and unfair practices.

*California Challenge to Funding Bank Program.* On April 13, 2021, a case was decided in the Northern District of California involving FinWise Bank, a Funding Bank, and its non-bank service provider, Opportunity Financial, LLC, challenging the validity of loans and business practices associated with a Funding Bank program.[426] The defendants removed the action, which had originally been filed in state court, to federal court and filed a motion to dismiss. The plaintiff, a California consumer, alleged that the defendants operated a "rent-a-bank" scheme to issue high cost loans although the bank was listed as the lender on the loans. The plaintiffs claimed the bank was lender in name only, with the service provider marketing the loans, purchasing the loans, and then servicing and collecting the loans, which actions the plaintiffs alleged were designed to evade California interest rate restrictions. The plaintiff made several claims against the defendants under both California and Utah law for unfair and unconscionable conduct and requested reformation of the loan contract and refunds for excessive charges. The defendants challenged all claims based on the doctrine of federal preemption and alternatively that if preemption failed, the action failed to state a cognizable claim under either state's law.

The court found that all of the plaintiffs' claims failed on the merits and, as a result, the court did not need to address or resolve the issue of federal preemption. In part, the court held that the plaintiffs failed to show that the defendants were subject to the California Financial Code, which contains wording to the effect that the California statute does not apply to any person doing business under any law of

424 As stated in the prior section, the court upheld the concept of valid when made based on the OCC regulation.

425 In a prior Massachusetts action, the court declined to deal with the true lender doctrine because it could decide the case on the basis of usury. The court dismissed the usury claims. *Kaur v. World Bus. Lenders, LLC et al.*, 440 F. Supp. 3d 111 (D. Mass. 2020).

426 *Sims v. Opportunity Fin., LLC et al.,* 2021 U.S. Dist. LEXIS 71360 (N.D. Cal. Apr. 13, 2021).

any state relating to banks. In that regard, the court upheld existing precedent that, as to usury, the court may look only to the face of the transaction and not to the intent of the parties.[427] On the face of the loan agreement, it was not subject to California law. The court noted that arguments as to evasion of California law are irrelevant since the bank is the lender on the documents. The court also reviewed the service provider's website and found that it was not misleading as to who was the lender on the loans. The court also dismissed claims under Utah law for unconscionability in that Utah law allows any rate of interest to be charged on a loan. A claim was also made under the Electronic Funds Transfer Act that a preauthorized transfer was required as a condition of the loan, and therefore the loan violated EFTA and Regulation E. The court found this claim to be insufficient based on language in the loan agreement allowing for alternative payment methods.

> There are no established judicial standards for making a true lender determination, which creates uncertainty in the market and challenges the doctrine of federal preemption conferred on insured banks by federal law. Litigation is both lengthy and costly. Many cases are being sent to arbitration.

### H. Recent True Lender Litigation

Most, but not all, of the recent actions filed against marketplace lending programs have been targeted at higher-rate, subprime participants. In addition, in order to avoid raising the issue of federal preemption, Funding Banks are usually excluded from such litigation. In many instances, the actions are brought in state court and the defendants remove them to federal court based on the existence of federal questions relating to preemption, and the plaintiffs then seek to remand the case back to state court. If the loan agreement at issue contains an arbitration clause, there is usually an attempt to compel arbitration and thereby avoid a class action proceeding.

Since the last update to this book there have been no significant decisions on the substantive aspects of true lender. There are several recent actions where arbitration clauses have been successful in compelling arbitration of true lender claims, resulting in a stay or dismissal of the action.[428] The *Happy* case referenced in the footnote is significant because, like many online programs, the challenge was based on whether a "click" button created a binding agreement to arbitrate. In this instance, there was only one click button that related to several agreements, including a hyperlinked loan agreement that contained an arbitration clause. The court ruled that the "accept and submit" click was enough to create

427 *Beechum v. Navient Sols., Inc.*, 2016 WL 5340454 (C.D. Cal. 2016).

428 *See, e.g., Dieffenbach et al. v. Upgrade, Inc.,* Case No. 4:23-cv-01427-MWB (M.D. Pa. filed Aug. 25, 2023); *Happy v. Marlette Funding, LLC*, Case No. 1:23-cv-00265-SPB (W.D. Pa. filed Sept. 6, 2023). In both of those cases, motions to compel arbitration were granted and the cases were dismissed. Pennsylvania has seen these purported true lender actions due to the fact that its usury rate is quite low, 6%. Other federal courts have also sent true lender claims to arbitration. *See Johnson v. Opportunity Fin., LLC,* Case No. 3:22-cv-00190 (E.D. Va. filed Mar. 24, 2023*); Fama v. Opportunity Fin., LLC,* Case No. 3:23-cv-05477 (W.D. Wash. filed May 25, 2023). Similar rulings are detailed in the true lender discussion later in this book.

a contractual agreement even if the borrowers had not read the linked documents. Part of the claim was that borrowers did not explicitly know that they were agreeing to arbitration. But the court found that the language made clear that the single click covered multiple agreements. Arbitration also thwarts class treatment of true lender claims and usually results in a settlement.

One decision of particular note comes from the Ninth Circuit Court of Appeals, a jurisdiction not particularly friendly to arbitration.[429] A case was brought against a fintech who was a service provider to a Funding Bank and purchased a participation interest in the loan that remained owned by the bank along with a portion of the loan.[430] The allegations were largely true lender in nature. Because the loan agreement with the borrower contained an arbitration clause, the fintech moved to compel arbitration. The district court denied the motion on the basis that the clause was unconscionable in that it contained a governing law provision of Utah, where the bank was located. The decision was appealed and the Ninth Circuit found that the arbitration clause was not unconscionable due to the choice-of-law provision and that it was up to the arbitrator and not the court to determine what law was to govern. In other words, the court made the decision that was delegated to the arbitrator to make. The court sent the case back to be arbitrated.

## I. Regulatory Actions and Challenges

Recently, when faced with potential regulatory action, some marketplace lending platforms are taking proactive measures to confront regulators before they are faced with regulatory action themselves. Noteworthy are actions brought against regulators in California and Oregon.

In March 2022, Opportunity Financial (*"OppFi"*), a financial technology platform, undertook an offensive strategy and brought suit for declaratory and injunctive relief against the California Department of Financial Protection and Innovation (*"DFPI"*).[431] The fintech seeks to bar the state regulator from applying state interest rate caps to loans made by a Utah state-chartered bank. The state was intending to bring an action against the company on a true lender theory and thereby apply the state interest rate cap rather than the rate that the bank would be able to charge to loans made to California borrowers. The fintech plaintiff is seeking a ruling to the effect that the state's usury limitations do not

429 *Carpenter v. Opportunity Fin., LLC,* Case No. 2:21-cv-09875-FLA-E (C.D. Cal. filed Feb. 22, 2021); decision appealed to Ninth Circuit Court of Appeals, Case No. 23-55553 (decided Mar. 21, 2024). A similar decision was made concerning a tribal loan agreement requiring the governing law to be tribal law. *Dunn v. Global Tr. Mgt., LLC et al.*, Case No. 21-10120 (11th Cir. decided Oct. 10, 2024) (holding the decision of the proper governing law to be utilized was a decision for the arbitrator).

430 While many marketplace programs sell whole loans or the total amount of receivables to the fintech service provider or a third party, many other programs only sell participation interests. In that scenario, the Funding Bank typically retains ownership of the loan and maintains a portion of ownership in the loan (thus having "skin in the game") and participating the remainder of the economic interest in the loan and right to collections. This is viewed as a helpful scenario for true lender purposes because the Funding Bank maintains the customer relationship and ownership of the asset while engaging in an economic transaction with a participant that provides the bank with liquidity. Established precedent as to loan participations is viewed as being supportive of the position that the Funding Bank is and remains the true lender.

431 *Opportunity Fin., LLC v. Hewlett*, Case No. 22STCV08163 (Sup. Ct. Los Angeles Cty. filed Mar. 7, 2022).

apply to loans made by a federally insured bank.[432] In doing so, it is claiming that the bank—not the platform—is the true lender on the loans because it extended the credit, is the named lender on the loan agreements with borrowers, and remains the owner and holder of the loans. As a result, under federal law, the loans made by the Utah bank under rates allowed to be charged by Utah banks would preempt California law.

> Some marketplace lenders are taking offensive action and even bringing actions against regulators.

Not to be outdone, DFPI filed a cross-complaint against the fintech, seeking to enjoin it from collecting interest in excess of California limits and declaring the loans void. The cross-complaint claimed the company was engaged in a "rent-a-bank ruse" to circumvent state usury laws. The state reiterated its claims that the platform was the true lender based on the primary fact that it holds the "predominant economic interest" in each loan transaction.[433] The state[434] also claims that in performing all of the functions of a traditional lending institution, including marketing, servicing, and having significant input into credit underwriting criteria, it is the true lender and subject to state law. The state seeks a permanent injunction declaring the loans void and prohibiting collection on the loans, in addition to restitution to borrowers to include removal of negative credit reporting and payment of penalties of at least $100 million.

Soon thereafter, in May 2022, OppFi filed a demurrer asking the court to disregard the state's pleading on the basis that, under California law and prior decisions, a loan made by an out-of-state bank does not fall within the jurisdiction of DFPI. It called the state's legal position "convoluted" in an attempt to make OppFi the lender on loans made by a bank. The court denied the demurrer in September 2022. In October 2022, OppFi filed a new cross-complaint against the state, calling the state's attempt to subject bank loans to state interest rate limitations "underground regulation." The pleading claims proper rulemaking was not engaged in by the state and therefore its actions were invalid. In February 2023 the state filed to obtain a preliminary injunction against OppFi to stop making loans in California. On October 30, 2023, the state court denied the state's motion for a preliminary injunction.

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432 In 2020, a California law took effect limiting the rate of interest that could be charged on loans over $2,500 up to $10,000. Known as AB539, this law capped rates at 36% plus the Fed Funds rate, whereas previously loans made by licensed lenders had been unrestricted. Prior to the law being enacted, OppFi and FinWise Bank in Utah began a loan program. The suit was filed after DFPI told OppFi that the bank loans were subject to California law and violated the restrictions of AB 539.

433 There is no definition of what constitutes predominant economic interest but DFPI claims in support of that allegation that OppFi meets that standard in that it purchases almost 100% of the loan receivables within three days after funding, insulating the bank from credit risk. The state also claims OppFi pays most of the costs of the arrangement, including a guaranteed monthly fee. The regulator also claims the cash collateral account to support receivables purchases is a prerequisite to funding.

434 The cross-complaint also alleges violations of the state's Consumer Financial Protection Law. While this law does not apply to a state licensee—which OppFi is—the state alleges that OppFi is not conducting activities under its license and therefore is subject to the consumer protection law and has violated its provisions. The state also seeks a permanent injunction against the use of preauthorized electronic payments by OppFi.

Of significance is that the court found that DFPI had not shown that it had a reasonable probability of prevailing on the merits of the case, a requirement in order to obtain injunctive relief. The case is scheduled for trial in 2026.

While the fact that the bank was the named lender on the loan was not decisive, unlike cases cited by DFPI, the bank in this instance was not a mere "dummy" but used its own funds to originate the loans and retained ownership of the loans, only selling receivables and the rights to payment to the fintech. In addition, the bank retained a 5% interest in the loans. Further, there was uncontroverted evidence that the bank managed the program and exercised oversight over the fintech and the underwriting criteria used for the loans. But the court placed emphasis on the fact that the bank had "skin in the game" by retaining an interest in each loan.

This continuation of this case will be watched with interest and, due to the size of the California lending market, the final outcome will be of import. The reach of the decision may also be limited given that the basis of the action relates to existing provisions of California law, not just determinations of federal preemption of state law generally.

In another western state, California's neighbor, Oregon, an action has been brought against the banking regulator (the Department of Consumer and Business Services) in federal court.[435] There, a bank service provider markets loans made by a Funding Bank, services the loans and purchases a participation interest in the loan, with the bank retaining ownership and an economic interest in each loan. The bank is also the secured party on collateral securing the loans. The state threatened an enforcement action against the service provider to void the loans because the interest rates were greater than the 36% allowed under Oregon's consumer finance act. While the state kept renewing the license of the bank service provider, in the proposed enforcement action it alleged that the service provider was the "true lender" on the loans. The court action seeks declaratory and injunctive relief affirming that the loans made by the Utah bank to the Oregon borrowers are subject to federal preemption.

### J. Tribal Lending True Lender Case Update

Some years ago the CFPB sued a tribal lender, CashCall, a case that has taken several twists and turns and is pending at the Ninth Circuit Court of Appeals.[436] CashCall made high-rate loans online through tribal bodies based on tribal law, claiming that such loans were not subject to federal or state law due to the sovereign immunity granted to Native American enterprises.[437] It was sued by the CFPB on

435 *Wheels Fin. Grp., LLC et al. v. Andrew R. Stolfi et al.,* Complaint for Declaratory and Injunctive Relief, Case No. 3:24-cv-1543 (D. Ore. filed Sept. 12, 2024).

436 The history of this case is depicted later in this text. *Consumer Fin. Prot. Bureau v. CashCall, Inc. et al.*, Case Nos. 18-55407 and 18-55479 (9th Cir.).

Tribal lending programs are fundamentally different from lending programs with federally insured depository institutions; thus, the determinations made with respect to tribal programs may have limited precedential value when related to notions

various theories and the district court found that that CashCall, not the tribal entities, was the true lender on the loans; restitution damages were determined to be over $200 million. CashCall appealed the award and the court imposed only a $10.3 million penalty, noting that the high rates were fully disclosed and consumers received what they had bargained for. Both parties appealed the damages award and the case was dormant while other cases were being decided primarily related to the constitutionality of the CFPB. Finally, in September 2021, the Ninth Circuit heard arguments on the damages issue. In February 2023, the district court awarded damages of $167 million against CashCall ($134 million in restitution and $33 million as a civil money penalty). In March 2023, CashCall asked the court to stay the action pending the United States Supreme Court's ruling on the constitutionality of the funding structure of the CFPB. Also in March 2023, the motion to stay was denied. Oral argument occurred in March 2024. The Ninth Circuit upheld the damages award in January 2025. CashCall has petitioned the U.S. Supreme Court to hear an appeal.

## K. State Statutes Take Aim at Marketplace Lending Programs on True Lender Basis

Beginning with Illinois in 2021, a few states have enacted laws directed at participants in the online lending industry.[438] These laws are aimed primarily at service providers and lending platforms that purchase loans or receivables from banks as part of online programs. The laws are often phrased as being applicable to those holding the "predominant economic interest" in a loan that exceeds a state's usury limitations (although that term has not been defined in those statutes). The laws are very broad and encompass a "totality of circumstances" terminology that suggests a program participant becomes the lender if an evaluation of the entire program warrants. Some of the matters considered are whether the participant designs and operates the program, has a right to purchase the loans or receivables, indemnifies the bank making the loan or is a service provider to the bank with respect to the origination and servicing of the program loans, and whether the participant works with banks in some states and makes loans on its own under state licenses in other states. Most of these laws also contain a broad "anti-evasion" provision that prohibits any act or practice that could be viewed as an attempt to circumvent the purpose of the statute. The effect of many of these laws is to potentially prohibit the purchase of loans in excess of a state's usury limitation or require the obtaining of a license to perform functions related to online bank programs. Interestingly, to date, there have been no known challenges to the validity or enforceability of these types of laws.

### *1. Illinois*

In addition to federal laws and regulatory oversight, some states have recently enacted legislation that potentially will impact marketplace programs and is related to licensing and usury. On March 23, 2021,

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of federal preemption. Tribal programs are almost wholly unregulated while programs with a Funding Bank are highly regulated, including the service providers to the banks involved.

438 See "Lending Laws, Licensing, and Related Litigation—State Statutes Take Aim at Marketplace Lending Programs on True Lender Basis" in the "Regulatory Issues" section of this book. Illinois, Maine, New Mexico, Hawaii, Wyoming and Nebraska have enacted such laws.

the Illinois Predatory Loan Prevention Act (the *"PLPA"*) was signed into law.[439] The PLPA imposes a 36% military annual percentage rate (*"MAPR"*) cap on all loans made to Illinois consumers.[440] It applies to all consumer loans made or renewed on or after the effective date of the PLPA. Failure to comply with the interest rate cap may result in the consumer loan becoming null and void. The PLPA applies to any person or entity that offers or makes a loan to a consumer in Illinois. While there is an exemption for banks, credit unions, and insurance companies that are chartered by the United States or any state, the PLPA has a sweeping "anti-evasion" provision to the effect that a person may be a covered lender by purporting to act as an agent of a bank or other exempt party and engaging in marketing, arranging, or brokering loans made by the exempt party, or holding or acquiring the predominant economic interest in the loans generated by the exempt party.[441] The anti-evasion provision of the PLPA appears to have been designed, in part, to limit the use of Funding Bank and service provider relationships commonly seen between banks and non-banks, such as fintech companies, marketplace lenders, and loan servicers, to operate loan programs with interest rates in excess of 36% MAPR.

A study examined the effects of the rate cap imposed by the Illinois Predatory Loan Prevention Act (PLPA) some two years after it became law.[442] The law mandated a usury cap of the Military Annual Percentage Rate of 36% on consumer loans made or offered by any person or entity, excluding banks and credit unions, to a consumer in Illinois. The study found that the 36% cap significantly decreased the availability of small-dollar credit in Illinois and worsened the financial well-being of many consumers. The study showed that loans to subprime borrowers decreased by 44% and that the average loan size increased. The number of state-licensed lenders dropped by more than 50% to 900. This has resulted in a decreased access to credit.

#### *2. Maine*

In 2021, Maine also updated its Consumer Credit Code to include a statutory "true lender" test, providing that an entity which is a purported agent or service provider is a "lender" subject to certain requirements of the Consumer Credit Code if the entity, among other things: (i) has the predominant economic interest in a loan; (ii) brokers, arranges, or facilitates a loan and has the right to purchase the

439 815 ILCS 123/15-1-1 *et seq*. The legislation was crafted without the knowledge of the state regulator and passed in record time without input from the industry or the regulator.

440 Note that the MAPR is calculated under the provisions and definitions of the Military Lending Act (*see* 10 U.S.C. § 987) and is NOT the same as the Annual Percentage Rate or APR calculation under the provisions and definitions of the Truth in Lending Act (*see* 15 U.S.C. § 1601 *et seq*.). The MAPR includes additional amounts related to credit insurance fees or premium, debt cancellation or suspension fees, ancillary products sold in conjunction with the credit, and, in the case of credit card, application fees and some participation fees.

441 The law does not define the term "predominant economic interest." Regulations were proposed and become effective August 1, 2022, including a separate disclosure informing consumers of the MAPR limitation and the fact that a loan above that rate is void.

442 Bolen, J. Brandon; Elliehausen, Gregory; and Miller, Thomas, Effects of Illinois' 36% Interest Rate Cap on Small-Dollar Credit Availability and Financial Well-being (Dec. 29, 2022), available at https://afsaonline.org/wp-content/uploads/2023/03/Academic-Study-on-Illinois-Rate-Cap.pdf.

loan; or (iii) based on the totality of the circumstances, appears to be the lender, and the transaction is structured to evade certain statutory requirements.[443] Under the new statute, if the deemed lender violates the provisions and lends in excess of the permissible state rate, the borrower is not obligated to pay the debt and may recover amounts previously paid on it.

### *3. Wyoming*

Wyoming amended its Consumer Credit Code effective July 1, 2021.[444] Under the new provisions, Wyoming changed its licensing statute to provide that, "[u]nless a person is a supervised financial organization or has first obtained a license from the administrator, no person shall engage in the business of making consumer loans or taking assignments of non-servicing rights relating to consumer loans that are not in default." The statute applies to all consumer loans that do not exceed $75,000. Thus, non-bank persons (such as the marketplace lending platform or a non-bank trust or special purpose entity) that take assignments of non-defaulted consumer loans may need to be licensed. The penalty for a non-bank taking an assignment of a consumer loan without a license is that the loan is void and the borrower is entitled to repayment of any principal and interest paid on such loan.[445] The Wyoming regulator has indicated that servicers are not required to be licensed if they do not take assignment of loans and that only an entity that takes assignment and services loans is required to be licensed. Further, the Wyoming regulator has indicated that an assignee such as a special purpose entity or trust not engaging in servicing does not require a license in Wyoming.

States are enacting laws that target marketplace lending programs, limiting interest rates and requiring licensing.

### *4. Hawaii*

Effective January 1, 2022, there is a new Hawaii licensing requirement for those engaging in business as an "installment lender" with respect to loans under $1,500.[446] The penalty for engaging in business without a license is that the loan is "void," and "no person shall have the right to collect, receive, or retain any principal, interest, fees, or other charges in connection with the loan." In addition to this licensing requirement, the new law contains requirements for installment loan transactions and renewals. A recent amendment to this law is discussed in the "Recent Developments in Marketplace Lending Regulation" section.

443 ME. REV. STAT. tit. 9-A, § 2-702 (effective Oct. 18, 2021).

444 WYO. STAT. § 40-14-302.

445 WYO. STAT. § 40-14-521.

446 H.B. 1192.

### *5. New Mexico*

On March 1, 2022, the governor of New Mexico signed into law House Bill 132, which caps interest rates at 36% for loans up to $10,000. The rates became effective on January 1, 2023.[447] The law also contains strong anti-evasion provisions aimed at Funding Bank-type programs as they apply to any agent or service provider of a bank where it holds the predominant economic interest or has the right to purchase the loan. The statute also provides that it applies where the "totality of the circumstances" indicate that the person is the lender and the transaction is structured to evade the requirements of the law.[448]

The "Recent Developments in Marketplace Lending Regulation" section provides updates on additional states enacting this type of law. There can be no assurance as to how these new laws will be applied in those states, but it is clear that they are intended to reach higher rate marketplace programs. In addition, it is possible that other states may follow suit, instituting similar statutory "true lender" tests, which may impact the ability to operate in those jurisdictions. Such statutes also raise the risk of true lender litigation as well as the tests applied by courts and regulators in determining who is the true lender of a loan. While such provisions provide additional clarity with respect to jurisdictional requirements, they may also result in increased usury and licensing risk and impact operations. Further, other states may take different paths to promulgate similar "true lender" restrictions, creating a patchwork of rules that federal preemption seeks to avoid; if not through a legislative path, impacted parties may have little to no advance notice of new restrictions and compliance obligations. These laws may also impair the ability to sell or securitize loans into the secondary market, reducing access to credit—often to those in need of it. Such laws may also be subject to challenge based on being an impediment to interstate commerce.

### *6. Maryland*

One regulator has taken another approach to derail marketplace programs based on licensing. In 2021, The Office of the Commissioner of Financial Regulation sued an out-of-state bank and its fintech service provider engaged in a Funding Bank program.[449] The state alleged that the parties were not licensed under applicable Maryland laws and therefore their loans were void. The bank and its service provider removed the matter to federal court based on preemption principles. In April 2022, the federal district court sent the parties back to the state administrative proceeding because the matter was based on

447 The law amends the Small Loan Act and the Bank Installment Loan Act. Previously, loans up to $5,000 could charge rates up to 175%. The "all-in" rate includes fees to obtain the credit, credit insurance premiums, and ancillary products.

448 In deciding whether the totality of the circumstances indicate that a person is the lender and a transaction is structured to evade the law, all relevant factors may be considered, including whether the person (1) indemnifies, insures, or protects an exempt entity for any costs or risks related to the loan, (2) predominantly designs, controls, or operates the loan program, or (3) purports to act as an agent, as a service provider, or in another capacity for an exempt entity while acting directly as a lender in other states.

449 *Salazar v. Fortiva Fin., LLC, Atlanticus Servs. Corp. and The Bank of Missouri s/b/m Mid-America Bank and Trust Co.*

issues of state licensing, not federal preemption of interest rates.[450] Accordingly, removal was not proper and the state proceeding was the appropriate place for the hearing. The case raises at least two important issues. First, while state banks are exempt from licensing in most places, this may not be the case in Maryland. Second, the state has long held the view that service providers to banks must be licensed under the state's Credit Services Business Act. In addition, the state claims that a collection agency license is needed to engage in collection activities. The court also found that the state administrative proceeding cannot be removed as it is not a court action, and only court proceedings can be removed; and even with an adverse determination, the state proceeding can be appealed to a court. The defendants attempted to certify the decision for appeal, but that motion was denied on July 8, 2022. In April 2024, a settlement was entered into. The Funding Bank was not required to obtain a license, but a debt collection entity did agree to become licensed under state law. A $275,000 fee was also paid to the state.

#### *7. Nebraska*

In 2021, Nebraska passed legislation that requires licensing for entities holding, servicing or otherwise participating in consumer loans made to Nebraska residents with an interest rate greater than 16% per annum, a principal balance of less than $25,000 and a duration of 145 months or less to have a physical location in the state. However, the physical presence requirement does not apply to owners, servicers or purchasers of installment loans if they are not making the loans. The state has taken an enforcement posture with respect to online programs requiring compliance with these requirements and has also indicated that the law would apply to securitization vehicles that hold loans.

#### *8. Washington*

In early 2023, the Department of Financial Institutions of the State of Washington announced that it was gathering information about fintech companies and their lending activity and relationships with out-of-state banks and credit unions. While acknowledging the right of banks and credit unions in other states to export their home-state interest rate to other states, including Washington, this may result in higher interest rates being charged to consumers in the state due to these fintech relationships. According to the state, it can be difficult to determine which entity in these relationships is the "true lender." The state issued "requests for information" from ten fintech companies working with out-of-state banks and credit unions, many of them subprime or higher-rate lenders. The state regulators indicated that such information would help them better understand these relationships, the terms of the financial products offered, whether such arrangements needed a Washington license, and how the products affect Washingtonians. In fact, Washington enacted changes to its consumer finance laws enacting amendments that contain anti-evasion provisions and restrictions on bank service providers effective June 6, 2024.[451] The law now includes an anti-evasion provision and provides that

450 Civil Action Case No. 21-cv-00866-LKG (D. Md. Apr. 28, 2022).

451 Substitute Senate Bill 6025 approved by the Governor on March 25, 2024.

bank service providers can be deemed the lender of a loan under certain circumstances. The law specifically states that if a loan exceeds the state's usury rate, a person is deemed to be the lender (and subject to the requirements of the state statute, including usury rates) if the person is an agent or service provider for an exempt entity and either holds, acquires or maintains the predominant economic interest in the loan or if the totality of circumstances would indicate that the person is the lender and the transaction is structured to evade the requirements of the statute. The law also adds a provision that states that it is a violation to engage in any action to evade the requirements of the law, "including but not limited to making, offering, or assisting a borrower to obtain a loan with a greater rate of interest … than is permitted by this chapter."[452] Violations of these provisions make the loan void and uncollectable.[453] The amendments also require licensing for persons engaging in any activity subject to the law.

#### *9. Connecticut*

Effective October 1, 2023, Connecticut amended its Small Loan Act. It increased the scope of the law to encompass lending transactions up to $50,000 from the prior $15,000. It also requires licensing for agents and service providers to exempt entities such as banks if the entity also acquires an economic interest in the loans or markets, brokers, arranges or facilitates the loan and has a right to purchase the loan, or otherwise evades the requirements of the Small Loan Act. The effect of these changes greatly expands the coverage of loans and makes online lending participants subject to licensing and other restrictions under the law.

#### *10. Minnesota*

Effective January 1, 2024, Minnesota enacted changes to its small dollar and payday loan statutes (loans up to $350 and $1,300, respectively), capping interest rates at 50% APR. The amended statutes also contain a broad anti-evasion law for bank service providers who obtain an interest in the loans or who otherwise act evasively to avoid the requirements of the statute.

#### *11. Wisconsin*

Effective January 1, 2025, Wisconsin changed its licensing law. On and after that date, assignees of loans with an interest rate greater than 18% will need to register as a licensed lender under the provisions of Wisconsin law. Previously, assignees had no such licensing requirement. This will affect marketplace lending participants that purchase or take assignment of loans for Wisconsin residents.

If these state laws continue to proliferate, it could have an impact on marketplace lending programs or later existing programs either to adhere to state usury limits or to discontinue offering products and services in states with those laws. It could also precipitate legal action to determine whether such laws

452 The Consumer Loan Act has a limit of 25%.

453 Wash. Rev. Code 31.04.035.

are valid or whether they would be invalidated by principles of federal preemption or other legal considerations.

State laws are also targeting non-bank commercial lenders enacting Truth-in-Lending-type disclosures for business loans. These statutes are discussed later in this publication.

***Final Thoughts—Structuring Funding Bank Relationships.*** So long as litigation and uncertainty surround the use of a Funding Bank for marketplace lending programs, when structuring arrangements with Funding Banks, lenders should use care to establish facts and factors that promote a sound foundation for finding that the Funding Bank is the true lender of the Borrower Loans.[454] Possible criteria to be considered include whether the Funding Bank is the named lender on the loan documents and distributes loan proceeds from its own funds; whether the Funding Bank shares or relinquishes control and risk to the marketplace lender, operational aspects, and payment of costs with respect to the program; whether the Funding Bank has loss exposure, protections, and indemnifications provided to the Funding Bank; the Funding Bank's right to deny credit or refuse to sell loans to the marketplace lender; the length of time that the Funding Bank holds the loans prior to selling them to the marketplace lender; and the compliance requirements imposed by the Funding Bank on the marketplace lender. Funding Banks need to exercise control over the program, including credit criteria and underwriting and program fees, and have the ability to audit the program and direct program changes. Funding Banks also need to have oversight over the services provided by the marketplace lenders and be sure that as service providers they follow vendor management protocol. Some Funding Banks are moving toward programs where the bank retains ownership of the loan and customer relationship and merely participates an economic interest to the marketplace lender based on long-standing precedent dealing with loan participations. Banks may also retain the right to keep loans rather than sell them. Collateral arrangements should also be undertaken with care so as not to appear to mitigate economic risk to the Funding Bank. True lender risk may be diminished by different entities being involved in the program and by a separation of origination functions from servicing functions from loan purchasers. Courts have looked to loan documentation and other communications with borrowers to determine the intent of the parties and also whether the Funding Bank is the true lender. Fundamental is that the Funding Bank is named as the lender on loan documentation and in related documents. Due to the complex issues involved, experienced counsel should be consulted to assist in the development of an appropriate strategy and drafting of arrangements between marketplace participants and Funding Banks.

454 For example, the parties should ensure that the bank has substantive duties and/or an economic interest in the program or loans. Banks should also take care to fulfill their obligations under applicable federal banking guidance to monitor and supervise the Internet marketer's performance of its duties as a bank service provider.

> **Takeaway:** Any finding by a court that a marketplace lender that utilizes a Funding Bank is the "true lender" of the loans originated through the platform could have serious consequences both for the marketplace lender and for investors in its loans, as the marketplace lender could be subject to sanctions for violations of state usury, licensing, or consumer protection laws and the loans themselves (depending upon the states involved) could be declared unenforceable in whole or in part or subject to repayment of excess charges or other penalties.

Prospective marketplace lenders should also note that third-party relationships entered into by financial institutions are in any case subject to increased regulatory scrutiny. A marketplace lender can expect some challenges in finding Funding Banks willing to take on the regulatory risk of third-party relationships, and should be prepared for extensive due diligence and for the Funding Bank to take an active role in establishing, approving, and monitoring the program since the bank remains responsible for its credit policies, loan forms, and compliance with applicable law. Accordingly, lenders are advised to take note of this issue and to consult with counsel when appropriate concerning third-party programs with financial institutions as well as regarding potential changes in regulatory attitudes.

### L. California Focus on Arbitration

In mid-2019 a mobile lending startup was sued by a consumer alleging that it would not let her pay off her loan while her membership fees remained unpaid.[455] Allegations in the case included violation of usury laws as well as violations of the federal Truth in Lending Act. The defendant filed a motion to compel arbitration based on arbitration provisions in the customer agreements, which the court granted in December 2019. The plaintiff has appealed that decision to the Ninth Circuit Court of Appeals.[456] In a 2021 ruling, the court upheld the use of arbitration.[457] California courts remain skeptical of arbitration provisions that attempt to curtail the availability of public injunctive relief. The decision, however, clarified that consumers can obtain "public" injunctive relief in "individual" lawsuits. Thus, arbitration agreements containing class action waivers, joinder waivers, and/or private attorney general waivers are likely to be found valid, so long as the agreements provide an individual with a right to public injunctive relief in an individual arbitration proceeding.

Unlike other states that have freely allowed arbitration under the Federal Arbitration Act,[458] California takes a contrary view and restricts the use of arbitration when the arbitration clause would prohibit the bringing of a public injunction.[459] As a result, efforts to move court actions to arbitration face a battle

455 *DiCarlo v. MoneyLion Inc. et al.,* Case No. 5:19-cv-01374 (N.D. Cal.).

456 *DiCarlo v. MoneyLion, Inc. et al.,* Case No. 20-55058 (9th Cir.).

457 Decision at 988 F.3d 1148 (9th Cir. 2021).

458 9 U.S.C. § 1 *et seq.*

459 *McGill v. Citibank*, 393 P.3d 85 (Cal. 2017).

in California. Even the use of an arbitration agreement may not be honored in California. But structuring of arbitration provisions to follow recent case law decisions provides a possible alternative to allowing arbitration if there is the ability of the individual to arbitrate the issue of bringing a public injunction.

This same online lending entity and its Funding Bank were sued in an action in North Carolina where the allegations included saddling borrowers with short-term loans with high interest rates without a license to lend in the state.[460] In December 2019, the court granted a motion to compel arbitration and stayed the actions. Objections to the ruling were denied. As stated elsewhere, the use of arbitration clauses in loan agreements can be beneficial.

Arbitration in California forums has been up in the air since the decision of *McGill v. Citibank, N.A.*[461] In short, an arbitration provision that deprives a consumer of the ability to bring an action for a public injunction violates California law and denies the ability to arbitrate. Litigation has resulted from this decision and lenders' changes to arbitration provisions to address this issue. A recent decision denied a motion to compel arbitration.[462] The argument that the litigant was not seeking a public injunction should allow arbitration was rejected. As a result, California arbitration provisions remain in a state of flux.

### M. State Licensing Requirements

Depending on how a program or platform is structured, various state licensing requirements could potentially apply. Even when a Funding Bank is utilized, participants may need state licenses in order to perform certain functions in the origination, funding, purchasing or servicing of loans.

> **Keep in Mind:** The federal laws that permit banks to "export" interest rates apply only to the rates and some related fees charged by the lender, and do not preempt state licensing laws or most other state consumer credit regulations and protections such as state disclosure requirements. Accordingly, the states will retain significant jurisdiction to regulate a marketplace lender in connection with loan origination and servicing activities even where a Funding Bank is utilized, and marketplace lenders are likely to be subject to licensing requirements.

The role and functions that an entity performs will determine whether licenses are required or not, and what licenses may be required. The general types of state licenses are described below. In some instances, more than one state license may be required.

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460 *Corpening v. MoneyLion Inc. et al.*, Case No. 3:19-cv-00282 (W.D.N.C.). The Funding Bank defendant is First Electronic Bank.

461 393 P.3d 85 (Cal. 2017).

462 *Snarr v. HRB Tax Grp., Inc.,* Case No. 19-17441 (9th Cir. Dec. 9, 2020). But see the "Regulatory Issues" section of this book for a California decision to the contrary.

***Conference of State Banking Supervisors.*** The Conference of State Banking Supervisors (*"CSBS"*) consists of the banking regulators from the various states. Given the development of technology and innovation, the state regulators began considering ways to promote innovation for companies subject to multistate licensing. In February 2019, the CSBS adopted several recommendations from its FinTech Industry Advisory Panel. These include development of a model law for all states to license money services businesses, creation of a standardized call report for consumer finance businesses and providing an online database of state licensing and fintech guidance. The CSBS agreed to develop an examination system to simplify examinations of state-licensed entities operating in multiple jurisdictions. The CSBS would also work to streamline state licensing application processes by expanding the use of the Nationwide Multistate Licensing System (*"NMLS"*) to all state regulators and entities supervised at the state level. NMLS is already used by several states to submit and process applications for state licenses.

***State Licensing Generally.*** Licenses are granted on a state-by-state basis and the requirements vary on that basis. In some states, the licensing process is fairly simple and straightforward; in other states, it is quite complex. Similarly, in some states licenses can be obtained fairly quickly while in other states (*e.g.,* California and New York) the process can take several months. In addition to filing fees, license applicants may be subject to background checks and fingerprinting and may be required to submit business plans and financial statements. A marketplace lender subject to state licensing requirements must also comply with any associated recordkeeping, financial reporting, disclosure, minimum net worth, surety bond, or similar requirements imposed by state law; must observe any limitations that applicable state laws impose on the business activities or practices of licensed entities (including any limits imposed on permitted rates or fees); and will be subject to examination by the applicable state regulators.[463] Some states have subscribed to the NMLS, a national licensing registration service that allows use of submitted information in multiple jurisdictions for licensing purposes. At least one state, Nevada, has a requirement of an in-state office for brokers and lenders of consumer and commercial loans, although online commercial lenders may meet the requirement to be exempt from the in-state office requirement. Accordingly, state licensing requirements may create significant compliance burdens and the need for a compliance infrastructure. This multistate compliance burden for lenders generally impedes having a uniform national program, which is one reason why the Funding Bank approach has been utilized for marketplace lending programs. However, to reiterate, even when working with a Funding Bank, marketplace lenders may need to obtain other state licenses to provide services to the Funding Bank or to acquire, service and collect loans.

State licensing authorities are taking an increased interest in marketplace lending as the sector grows. The California Department of Financial Protection and Innovation (formerly the Department of Business Oversight) launched an inquiry into online programs in December 2015 with the objective of determining whether market participants are fully complying with the state lending and securities laws.

463 Loan broker and collection agent registration and licensing requirements as well as other requirements imposed on loan brokers and collection agents vary from state to state. Careful consideration of applicable laws is required before arranging or servicing loans in any given state.

The department sent an online inquiry to fourteen consumer and business lenders including merchant cash advance businesses, requesting five years of data about each such company's loans and investors. Responses from those entities were due March 9, 2016, and the department published a summary report of the aggregate transaction data on April 8, 2016. More recently, the New York Department of Financial Services (*"NYDFS"*) circulated a similar survey to online lenders to gather information for a report issued in 2018 suggesting that additional licensing requirements should be considered for online lenders and recommended a lower usury rate. In general, though, state regulators are starting to focus more attention on marketplace lending and the need for licensing depending upon how such businesses are conducted.[464]

Below is a brief description of the different types of state licensing requirements that could apply to a marketplace lending program.

***Broker and Lead Generation Licenses.*** Certain states require the registration or licensing of persons who assist in the loan marketing and origination process under "loan broker" or "credit service organization" statutes. Some states, such as Connecticut and New Hampshire, require licensing for persons who solicit loans for others. Other statutes may define a "loan broker" to include any entity that, for compensation, arranges for the extension of credit for others.[465] Any participant hosting a website or soliciting loans for a Funding Bank may fall within one or more of these broad definitions and, absent an exemption, will need to comply with any associated licensing requirements imposed by those applicable states for loan brokers, marketers, or originators.[466] Even lead generators and aggregators may be subject to these laws. At least one state, Vermont, requires a license for lead generators/aggregators.

***Lending and Assignee Licenses.*** Consumer marketplace lenders that do not utilize a Funding Bank are subject to lending license requirements in virtually all states. State regulators take the position that Internet lenders must be licensed by the state to make loans to residents of that state.[467] Persons who

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464 However, a recent California enforcement action decision appears to expand entities that need to be licensed under the California Financing Law. The decision upheld a cease-and-desist order against an entity that did not fund loans to borrowers but solicited borrowers, evaluated the credit, proposed loan terms, and made or participated in credit advances. The Department rejected the argument that a license was needed only if the entity made loans. Lending-related activities may also require licensing. *In the Matter of the Desist and Refrain Order Against Fin. Servs. Enter. dba Pioneer Capital*, OAH No. 2016040551 (Nov. 29, 2016). California has taken a more aggressive posture on licensing enforcement actions.

465 Each statute is potentially different and needs to be reviewed for applicability. Compensation, for example, could be general such that any compensation received in a transaction gives rise to licensing, while in other jurisdictions compensation may be required from a borrower.

466 Some states have enacted credit service organization laws that have potential application depending upon how the statute is drafted. These laws could impose licensing or other restrictions on marketplace lenders. Some impose disclosure requirements that are inappropriate to marketplace lenders. In some states, money transmitter licenses could be a consideration.

467 *See, e.g., Cash America Net of Nevada, LLC v. Commonwealth of Pennsylvania*, 2010 Pa. LEXIS 2386 (Pa. Oct. 19, 2010), holding that an Internet lender making loans to Pennsylvania residents over the Internet from its location in Nevada required licensing under the state's Consumer Discount Company Act even if it had no offices or employees in the state. In October 2016, the Georgia Supreme Court ruled that out-of-state Internet lenders are subject to the state's payday lending law,

"arrange" loans for others are also covered by the lending license statute in some states.[468] In some cases, a purchaser or assignee of a Borrower Loan may become subject to licensing requirements.[469] Some states require licensing of commercial lenders.[470]

***Collection/Servicing Licenses.*** States may also require marketplace lenders who undertake collection activities for others to be licensed as "collection agents." Servicers including marketplace lenders who are administering and servicing Borrower Loans for others may also be subject to servicing and/or state debt collection licensing. Even if a marketplace lender outsources collection activities to a licensed third party, in some states, it too may be subject to collection licensing requirements.[471] This could apply to an entity that sells loans to a third party and retains servicing of the loans, including marketplace lenders that sell loans to investors and then service the loans on behalf of the purchaser. Additional state-level requirements that may be applicable to lenders that service Borrower Loans are described in "Debt Collection Practices" below.

***Money Transmitter Licenses.*** Most states also have statutes that deal with money transmission. If one meets the state's definition of engaging in a business that transmits money, then a state money transmitter license may be required. If a marketplace lender handles funds directly, then inquiry about the applicability of money transmitter laws should be undertaken.

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which prohibits making loans of $3,000 or less without a license. *Western Sky Fin., LLC v. State of Georgia*, No. S16A1011 (Oct. 31, 2016).

468 For example, the Regulated Lender statute in Texas contains this type of language and the regulator there has indicated that Internet platforms sourcing loans for a bank located in another state need to be licensed under this law. In addition, in late 2016 the California regulator took action against a company that arranged commercial loans, finding that a license was required under the California Finance Lenders Law (as of October 2017, renamed the California Financing Law) because the company was engaged in the business of making commercial loans even though it did not actually lend money or take security. We note that merchant cash advance businesses conduct business over the Internet. A discussion of the laws applicable to that arena are beyond the scope of this book; however, if structured correctly, such advances are in the nature of receivables purchases or factoring and not loans and should fall outside of typical lending requirements. Litigation has occurred over this issue, most prevalently in California, and some merchant cash advance businesses obtain licenses.

469 Any loan assignee (even a passive investor) is subject to licensing in Kansas (Supervised Lender License required with respect to loans over 12%; see KAN. STAT. § 16a-2-301(1)(6)) and South Dakota (Money Lender License, S.D. STAT. § 54-4-52) and potentially in other states (*e.g.,* installment loans of $6,000 or less in Massachusetts—MASS. GEN. LAWS ch. 140 § 96) and perhaps other states. Assignees who also service and collect consumer loans are potentially subject to licensing in several states including Colorado, Connecticut, Idaho, Iowa, Louisiana, Maine, Oklahoma, South Carolina, Utah (notification), and Wyoming. In addition, certain types of loans may be subject to restrictions on assignment. Loans made under the Illinois Consumer Installment Loan Act may only be sold to regulated financial institutions or other licensees. Loans made under the Massachusetts Small Loan Act may only be assigned to other licensees or exempt entities. The same is true for Ohio Small Loans (loans under $5,000). Some states such as Texas impose licensing on any entity that charges, contracts for or receives interest greater than 10%.

470 Some seventeen states potentially have licensing requirements applicable to commercial lenders. Some are based upon type of entity (*e.g.,* sole proprietor lending requires licensing in some states) or rates in excess of certain amounts. Legislation is pending in some states that would expand the number of state licensing commercial lenders.

471 *Barbato v. Greystone Alliance, LLC,* Case No. 18-1042 (3d Cir. Feb. 22, 2019).

***Credit Services Organizations Licenses—Maryland Decision.*** Several states have credit service organization, or CSO, statutes. While aimed at persons who try to improve a person's credit standing or credit record, many of these statutes also apply to entities that assist a borrower or a lender in obtaining a loan. Some states require borrowers to compensate the entity, while others define compensation more broadly. A decision of the Maryland Court of Appeals demonstrates the need for marketplace lenders to review state licensing requirements carefully since non-uniform requirements can prove a trap for the unwary. On June 23, 2016, the court filed a decision in *CashCall, Inc., et al. v. Maryland Commissioner of Financial Regulation*, upholding the $5.6 million in sanctions imposed by the Commissioner against CashCall.

In this case, CashCall was utilizing the Internet to market loans to Maryland residents that were made by two federally chartered banks not located in Maryland, at rates up to four times greater than the maximum rate allowed under Maryland's usury laws. Soon after the banks made the loans, CashCall purchased the loans and serviced and collected them. The regulator in Maryland cited CashCall for failure to obtain a license under the Maryland Credit Services Business Act (the *"CSBA"*). In addition to requiring a license for any credit services business, the CSBA contains a provision that prohibits a person from arranging loans for banks that would be in excess of allowable Maryland rates. The regulator claimed CashCall was a credit services business and fined it $1,000 for each loan it arranged for the banks with Maryland residents that exceeded Maryland's applicable usury rate.

CashCall argued on appeal that it was not engaged in a "credit services business" and therefore had not violated the CSBA. The CSBA defines a "credit services business" as one in which a person obtains or assists a consumer in obtaining an extension of credit "in return for the payment of money or other valuable consideration."[472] In an earlier decision the Court of Appeals had held that under the quoted language, a business is a "credit services business" only if the payment it receives for arranging an extension of credit comes "*directly from the consumer*."[473] CashCall argued that it received no compensation from borrowers, but only royalty fees paid by the Funding Banks; thus, it had not received any payments "directly from the consumer" and was not subject to the CSBA. The court rejected CashCall's argument, clarifying that the direct payment requirement only applies to companies that are primarily engaged in providing goods or services to consumers other than arranging extensions of credit, and does not extend to a company that is exclusively engaged in assisting Maryland consumers in obtaining loans. The court further stated that the Maryland legislature had intended the CSBA to prohibit payday lenders from partnering with non-Maryland banks to extend loans at rates exceeding the Maryland usury caps, and that it would undercut the purpose of the legislation to limit its application to loan marketers who receive direct payments from the borrowers beyond the payments made on the loan. In fact, the court said that CashCall's activities were exactly what the Maryland legislature had intended the CSBA to prohibit.

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472 MD. COM. LAW § 14-1901(e).

473 *Gomez v. Jackson Hewitt, Inc.*, 427 Md. 128, 154 (2012) (emphasis added).

The court did, however, acknowledge that the CSBA only applies to loan marketers who provide their services "in return for the payment of money or other valuable consideration." In this regard, the court held that CashCall's right to receive principal, interest, and fees on the loans it purchased from the Funding Banks constituted adequate "consideration" for purposes of the statute. In fact, said the court, the overall arrangements between CashCall and the Funding Banks (under which the latter retained no economic interest in the loans) appeared to constitute a "rent-a-bank scheme" that "rendered CashCall the *de facto* lender." This latter statement is interesting to the extent it suggests that the Maryland courts may be willing, at least in some circumstances, to apply the "true lender" doctrine to loan marketers if the originating bank has no continuing economic interest in the loans.[474]

> **Takeaway:** The court's decision potentially creates significant issues for marketplace lenders who partner with non-Maryland banks to offer consumer loans to Maryland consumers. First, the decision impacts licensing as it could require non-bank marketplace lenders to obtain credit services business licenses to market loans originated by a financial institution. The decision may also indicate that marketplace lenders need to adhere to the substantive provisions of the CSBA, including the prohibition on soliciting Maryland residents for loans at interest rates exceeding the applicable usury caps permitted under Maryland law (24%). Accordingly, the decision has implications for unlicensed entities that are marketing loans and/or for entities who solicit loans for others in excess of Maryland permissible rates.[475]

***Massachusetts—License Violations Yield $2 Million Penalty and Customer Reimbursement.*** On March 12, 2018, the Massachusetts Division of Banks entered a consent order against LendingClub and its subsidiary Springstone Financial, LLC based on failure to be properly licensed. The state regulator alleged that the marketplace lender was engaging in the business of being a third-party loan servicer and arranger of small loans for a fee without holding a servicer registration or small loan license.[476] As part of the consent order, LendingClub paid an administrative penalty of $2 million and agreed not to engage in licensable activities without having the necessary license.[477] In addition, LendingClub was required to reimburse consumers for any interest or fees on small loans arranged or serviced by

474 The practical reality is that a marketplace lender may not be able to solicit loans for a Funding Bank in excess of Maryland usury rates. The penalties may not affect the enforceability of the loan, but could impose the statutory penalties on the marketplace lender.

475 The decision could also have ramifications in other states with credit services organization licensing laws where ostensibly payment is required directly from the consumer.

476 A small loan license is required under MASS. GEN. LAWS ch. 140 § 96 to arrange, negotiate, aid or assist a borrower or lender in procuring or making loans of $6,000 or less at a rate greater than 12% APR. That law applies to closed-end credit, but not open-end credit. Persons must register prior to acting as a third-party loan servicer in Massachusetts pursuant to MASS GEN. LAWS ch. 93 § 24A.

477 As part of the proceeding, the marketplace lender obtained both a Massachusetts third-party loan servicer registration and small loan license.

LendingClub since August 1, 2011 that were in excess of the amount permitted under the state's small loan law. Some marketplace lenders only engage in activities related to loans greater than $6,000 in Massachusetts to avoid the small loan licensing requirement.

> **Caution:** This enforcement action is a reminder that marketplace lending participants may be subject to various state licensing regimes and failure to obtain necessary licenses can result in fines and penalties and even, as in this case, customer reimbursement.

***New Hampshire—License Violations.*** Similar to the Massachusetts state regulator action above, the New Hampshire Department of Banking has recently entered into a number of consent orders with marketplace lenders for their failure to have a small loan license.[478] Under New Hampshire law, the definition of a small loan lender includes any person acting as a finder or agent for a lender or a borrower who assists in the arranging, finding or procurement of a loan.[479] The state regulator takes the position that making a website available to New Hampshire residents for the purpose of finding a loan implicates the licensing requirement. The consent orders have required marketplace lenders to either become licensed or cease and desist from small lending activity in the state, and has imposed fines and penalties for violations.

***Actions by Attorney General in Virginia.*** The Attorney General in Virginia has been active in pursuing online lenders, although most of this activity has been focused on predatory lending tactics. For example, in October 2017 the Attorney General reached a settlement with an online lender that advertised on its website that it was licensed by the state of Virginia and its Bureau of Financial Institutions, when it was not so licensed.[480] In addition to this misrepresentation, the lender was charging borrowers rates in excess of Virginia's general usury limit of 12%, which applies to unlicensed lenders. In November 2017, the Attorney General reached a settlement with a high-rate online payday lender charging triple-digit interest rates, imposing a $3 million penalty.[481] In February 2018, the State recovered $2.7 million from another online lender that claimed it was licensed by the state when it was not and was charging unlawful fees.[482] Also in February 2018, a six-figure settlement was reached with eight affiliated online lenders and debt collectors regarding an open-end credit program.[483]

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478 *See, e.g.,* N.H. Banking Department Consent Orders against Klarna Inc. d/b/a Klarna Credit (Nov. 8, 2017), Career Bridge Inc. d/b/a Career Bridge (Dec. 27, 2017).

479 N.H. R.S.A. 399-A-1. Small loans are loans of $10,000 or less with an APR of more than 10%.

480 *Commonwealth of Virginia v. Mr. Amazing Loans, Assurance of Voluntary Compliance* (Oct. 13, 2017).

481 *Commonwealth of Virginia v. Opportunity Financial, LLC, Assurance of Voluntary Compliance* (Nov. 30, 2017).

482 *Commonwealth of Va. v. MoneyLion of Va. LLC, Assurance of Voluntary Compliance* (Feb. 5, 2018).

483 *Commonwealth of Va. v. Field Asset Service Team, LLC et al., Assurance of Voluntary Compliance* (Feb. 5, 2018).

***Legislation Affecting Lead Generators—Vermont.*** In what could become a growing trend, Vermont enacted a law requiring various entities to obtain a loan solicitation license, including lead generators and others who engage in online marketing, loan comparison and making referrals to others.[484] It appears that the law applies to both consumer and commercial loans. The license is obtained through Vermont's Department of Financial Regulation. In addition to licensing, the law requires loan solicitors to make certain disclosures including that they are not the lender and that consumer information will be shared with others.[485] Many states' broker licensing laws are unclear as to whether technology firms such as lead aggregators or loan comparison websites must be licensed; however, Vermont has taken action to clarify its position with this new law, which took effect May 4, 2017.

***Vermont Licensing Exemption for Business Lending.*** Vermont has enacted a broad law pertaining to loan solicitation which requires licensing of any loan solicitation or lead generation activity.[486] The law also allows the Commissioner of the Department of Financial Regulation to exempt from licensing certain categories of loans or service providers.[487] In September 2018, the Commissioner entered an order exempting from the statutory licensing requirements loan solicitation companies that partner with an FDIC-insured bank in making commercial loans.[488]

The state regulator noted that when loan solicitation activities are conducted online and in conjunction with an FDIC-insured bank, the loan solicitation company and activities are subject to supervision, oversight, regulation and examination by the bank's state and federal regulators.[489] As a result, the loan solicitation activities are monitored and managed by the bank, including regulatory guidance on third-party providers, and therefore sufficient protection is provided for commercial borrowers. Accordingly, the Commissioner exempted from licensing companies that partner with FDIC-insured banks to solicit commercial borrowers and where the bank extends the loan. However, the order noted that an exemption for consumer loans might not be appropriate due to greater restrictions and protections afforded to consumers.

***Sandboxes—Arizona, Wyoming, and D.C.*** In March 2018, Arizona became the first state in the country to enact legislation to establish a regulatory "sandbox" designed to help fintech companies test innovative products and services in a limited manner without total compliance with licensing or other

484 H.182 (Act 22).

485 8 V.S.A. § 2220a.

486 8 V.S.A. § 2200(14). This law requires that persons who provide any assistance to lenders in connection with the making of loans (including through the Internet) obtain a loan solicitation license. Marketplace lending platforms would therefore be required to obtain a license in order to provide services to a Funding Bank for loans made to Vermont residents. In addition, the statute requires licensing for lead generation activities including the referral of Vermont borrowers to others for loans.

487 8 V.S.A. § 2200(17)(B)(vi).

488 Order of State of Vermont Department of Financial Regulation, *In Re: Licensing Exemption for Loan Solicitation Companies that Partner with FDIC Insured Banks to Extend Commercial Loans,* Docket No. 18-041-B (Sept. 18, 2018).

489 Citing, among others, the Bank Service Company Act, 12 U.S.C. § 1867(c).

applicable requirements.[490] Arizona has publicly announced that it is taking applications for this program.

On February 19, 2019, the Governor of Wyoming signed into law an act creating a financial technology sandbox for financial products and services in the state.[491] Upon application and receipt of a bond, specified statutes or rules may be waived to provide for the testing of new products and services. The program is limited to new innovations that cannot be made under current law.[492]

On January 23, 2019, the District of Columbia established a Financial Services Regulatory Sandbox and Innovation Council. The body will issue a report within six months concerning the feasibility of having a regulatory sandbox in the District of Columbia for financial products and services. The scope of the report includes blockchain and smart contract technology as well as financial, insurance and regulatory technology products and businesses.

### N. State Business Loan Disclosure Laws

Several states, notably California and New York, have enacted some form of consumer-like disclosures for commercial loan products, and each one of them is somewhat different. Congress and some other states are considering similar types of disclosure.[493] These laws will likely impact some marketplace lenders, making operations more difficult, and are a move toward patchwork regulation of business lending.

> Several states have enacted or are considering consumer-like disclosures for business loans and financings, sometimes including factoring and merchant cash advances.

#### *1. California*

In 2018 California was the first state to enact a business loan disclosure law.[494] Final regulations became effective December 9, 2022. Unique to the California provisions, the borrower would need to sign the disclosure, which requires disclosure of several things including total funds advanced, the total cost, the term, payments, and prepayment penalties. The law affects loans to $500,000 and exempts banks and real estate secured loans but applies to non-bank partners of exempt entities. The law reaches not just

490 H.B. 2434, codified at ARIZ. REV. STAT. §§ 41-5601-5612.

491 H.B. 57 (Financial Technology Sandbox Act), effective Jan. 1, 2020.

492 In September 2020, Wyoming chartered a new type of digital bank to engage in cryptocurrency transactions.

493 Some of the laws in states such as Missouri and Utah require registration and some as in Virginia only apply to merchant cash advances. Georgia, Florida, Connecticut and Kansas have laws on the books and other states are considering them. See the "Recent Developments in Marketplace Lending Regulation" section for more detail.

494 S. 1235 enacted Sept. 30, 2018.

open-end and closed-end loans but also merchant cash advances, factoring arrangements, and asset-based lending transactions.[495]

### *2. New York*

The New York legislature passed a law requiring disclosures on a broad set of commercial-related financings up to $2.5 million.[496] Final Regulations were published, and compliance became mandatory, on August 1, 2023. Unlike California's law, the Empire State's provisions apply to brokers, but, similarly, the law also covers merchant cash advances and factoring. While banks are exempt, bank subsidiaries and affiliates are not. The disclosure requirements are similar to, but not the same as, those in California.[497] Unlike California, the New York law does not apply to technology service providers to exempt institutions.

### *3. Utah*

In March 2022, Utah enacted the Commercial Financing Registration and Disclosure Act, effective January 1, 2023.[498] Unlike New York and California, Utah has imposed no APR disclosure requirement.[499] The law applies to loans up to $1 million. In addition to disclosures required to be made in other states, Utah requires disclosure of any costs or discounts associated with prepayments and disclosures of payment made to brokers. The law also contains a registration requirement and focuses on accounts receivable purchase transactions, commonly known as merchant cash advances. Specifically, the law covers a "provider," which exempts depository institutions and their subsidiaries or service corporations but includes a person with a written agreement with a depository institution that offers commercial financing products of that institution via an online platform. Given that several Funding Banks are located in Utah, this law affects online commercial lending programs made with a

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495 Some lenders are located in California and use a California governing law provision in their loan agreements. That fact could impose the disclosure requirements in all states using a California governing law provision. The law applies to Financing Law licensees, so out-of-state lenders holding a California license will at a minimum be subject to the requirements for their California portfolio of loans.

Merchant cash advances are contractual arrangements whereby merchants sell some portion of their future sales (accounts receivable) to the cash advance provider. A discussion of this type of financing is beyond the scope of this book but much of this business is conducted online and a separate body of law has developed in connection with these arrangements, largely in connection with litigation claiming such arrangements are loans rather than purchases and courts finding that they are valid sales where typically there is no credit recourse back to the merchant. *See, e.g., LG Funding v. United Senior Props. of Olathe*, 181 A.D.3d 664, 666 (N.Y. 2d Dep't 2020).

496 Codified at NY FIN. SERV. LAW §§ 801-812.

497 New York requires disclosure of the amount of the loan as well as the amount disbursed to the borrower, finance charges including an APR, repayment terms, other fees, and any collateral securing the loan. Each state's law in complicated and there are some differing requirements for different kinds of financing products. A discussion of the specifics of those laws and the pending regulations is beyond the scope of this book, but business lending programs should carefully consider these laws and their potential implications.

498 Codified at UTAH CODE § 7-27-101 *et seq.* (S. 183 enacted Mar. 24, 2022).

499 Interestingly, some fintech platforms testified at a hearing in Utah on the measure and asked lawmakers to include APR disclosures so that businesses would adequately compare loan terms.

Utah-located Funding Bank. While the law places limits on the amount of civil penalties that can be imposed and does not appear to create a private right of action, it does specify that violations of the law will not affect the enforceability of the loan.

#### *4. Virginia*

In April 2022, Virginia enacted a law limited in scope to merchant cash advances or "sales based financing."[500] The law contains both disclosure provisions and registration requirements. The disclosures become effective on July 1, 2022, and registration is required by November 1, 2022, for existing providers. Apparently recognizing the difficulty in determining an annual percentage rate on merchant cash advance transactions, the law does not require disclosure of an APR but contains disclosure requirements of other terms, similar in content to those required under the New York law discussed above. In addition, the law prohibits the use of confession-of-judgment clauses, requires all actions to be in Virginia, and limits arbitration to the venue of the principal place of business of the merchant.

In March 2023, based upon a request from a trade association, the CFPB issued a determination that the federal Truth in Lending Act does not preempt the above-described disclosure laws in those four states.

**Georgia** enacted a law for loans up to $500,000. It includes participants in marketplace lending arrangements that engage in more than five transactions. Like other similar laws, real-estate-secured transactions are not covered.

**Florida** enacted a law that applies to providers of commercial financing transactions up to $500,000. Financial institutions and licensed money transmitters are exempt from coverage.

**Connecticut** passed a similar law but it is limited to sales-based financing such as merchant cash advances.

The **Kansas** law took effect on July 1, 2024, and applies to commercial financing transactions to $500,000. It requires various disclosures to be made prior to or at the time of consummation of the transaction.

**Missouri** also enacted a disclosure law similar to the ones described above and also has a registration requirement for brokers.

> California imposes disclosure requirements on commercial loans, including online platforms using a Funding Bank arrangement. So do New York, Florida, Georgia,

500 H.B. 1027, enacted Apr. 11, 2022.

> Missouri, Kansas, and Utah. Virginia and Connecticut have requirements for merchant cash advance programs.

***Attorneys General.*** Although several state attorneys general indicated that they would fill the gap if the CFPB slowed down its enforcement posture, making good on that pledge has not been obvious. Only a few states, including Pennsylvania and New Jersey, have announced plans to establish "mini-CFPBs" to focus on consumer protection issues. Maryland has created a Financial Consumer Protection Commission. Virginia has created a special unit targeting predatory lenders and has been active in enforcement, including actions against online unlicensed lenders.[501] Massachusetts is investigating the advertising and disclosure practices of a marketplace lender.[502] California enacted legislation to establish a mini-CFPB.

***New York—Online Lending Report.*** In July 2018, the New York Department of Financial Services (*"NYDFS"*) issued its report on online lending, based in part on responses that the NYDFS received from questions it had posed to participants in the online lending industry. The report takes the position that the state's consumer protection laws and regulations should apply to all consumer and small business lending. This would mean that small business lending would be subject to consumer disclosure standards and other consumer-oriented laws. The report also took the position that the state's usury limits should apply to all lending in New York. The NYDFS stated that a borrower deserves to get the benefit of New York's protections whether they borrow from a bank, a credit union or an online lender. This appears to be a challenge to the federal preemption and rate exportations that many banks and marketplace lenders use for their programs. In fact, the NYDFS suggested that the usury rate be reduced from the current 16% to 7%, which would require more entities to become licensed (*i.e.,* loans at rates in excess of 7% would still be permitted, but only by licensed lenders). The NYDFS took aim at online lenders, asserting that the licensing of online lenders is needed, which would allow for the state to supervise and provide oversight as to safety and soundness and consumer compliance of those entities.[503] Future legislative sessions may consider these proposals.

***California Targets Lead Generators.*** The California Department of Financial Protection and Innovation has been aggressive in targeting lead generators for operating in the state without obtaining a broker license under the California Financing Law. That law requires a license to broker loans to a lender who

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501 *See, e.g., Commonwealth of Virginia v. NC Fin. Sols. of Utah, LLC* (Cir. Ct. Fairfax Co.), Civil Action Case No. 2018-06258 (filed Apr. 23, 2018) (action against out-of-state online lender not licensed in Virginia and using a Utah choice of law with no Utah connection).

502 In a regulatory filing, LendingClub Corp. disclosed that it had received a civil investigative demand in June 2018 from the Massachusetts Attorney General and is cooperating with the investigation. The settlement of the resulting action is discussed elsewhere.

503 The NYDFS Superintendent, in an October 2018 interview, indicated that the NYDFS was considering whether to impose new licensing requirements for online lenders operating through bank partnerships. That superintendent has subsequently left the NYDFS.

is also licensed under the California Financing Law.[504] The state regulator has taken the position that websites offering loans that are sourced to California licensees or taking application information either directly or from other websites and relaying it on to other lenders for a fee should be required to obtain a broker license under that California statute.[505] The state specifically declared that collecting consumer loan applications or application data and forwarding it to a licensed lender for the purposes of making a loan is acting as a broker. Furthermore, under the California Financing Law, it is unlawful for a licensed lender to pay a fee to an unlicensed person for broker services. The state regulator has also brought actions against licensed lenders for paying unlicensed lead generators for leads and referrals.[506] A lender was cited for referring its declined applicants to other lenders for a fee if a loan was made without being licensed as a broker. It is anticipated that California will continue to monitor the activities of lead generators and licensees relative to online websites and loans for compliance with the licensing requirements under the California Financing Law.

The activities of lead generators are becoming subject to more scrutiny by regulators.

***Enforcement Actions Target Lead Generators.*** Lead generators have also been subject to scrutiny in some of the largest states. In California, the former Department of Business Oversight (*"DBO"*) recently brought a number of actions against licensees under the California Financing Law[507] for paying unlicensed lead generators for referrals in violation of California regulations.[508] These actions have resulted in penalties and customer refunds. In one case, the DBO revoked a company's license for paying unlicensed entities for leads and loan referrals.[509] In the past, New York has also sanctioned lead generators.[510] Penalties and customer reimbursement were ordered by the NYDFS for misrepresentations concerning the safety of personal information and for knowingly advertising and soliciting for loans in violation of New York's usury limits.

504 CAL. FIN. CODE § 22100.

505 *See, e.g., Desist and Refrain Order* (Zero Parallel, LLC Dec. 7, 2018) (selling of borrower data to lenders by means of a "ping tree").

506 *See, e.g., The Comm'r of Bus. Oversight v. Avant of Cal., LLC,* Consent Order, CFL File No. 603-K-124 (Jan. 31, 2019).

507 Legislation effective October 4, 2017, changed the name of California's licensing law from the California Finance Lender's Law to the California Financing Law.

508 CAL. CODE REGS. tit. 10, § 1451(c).

509 *The Comm'r of Bus. Oversight v. Wheels Fin. Grp., LLC et al.,* Settlement Agreement (Feb. 22, 2017).

510 *See, e.g., In re Blue Global, LLC et al.,* 2016 WL 1146396.

## O. State Licensing

### *1. Nevada—Commercial Lenders*

Nevada licensing rules have proved to be a stumbling block for online lenders. The Installment Loans and Finance Act[511] applies to both consumer and commercial loans and also applies to both lenders and those soliciting loans on behalf of lenders. The statute requires that the licensee have a physical location (brick and mortar) in Nevada.[512] This is, of course, problematic to entities conducting business totally online without any physical locations. However, under a law passed in 2019, some relief has been afforded to commercial brokers and lenders. The law exempted business lenders who only made loans via the Internet exempt from the requirement of having an in-state physical presence.[513] Entities needing licensing related to consumer loans are still subject to the location requirement, which remains problematic for marketplace lenders.

### *2. Wyoming—Special Purpose Depository Institution*

Wyoming enacted legislation in 2019 that allowed for the creation of a "special purpose depository institution" targeted at fintech companies and innovation.[514] The state indicated that such banks would focus on digital assets such as virtual currencies, digital securities and utility tokens and resemble custody banks focusing on fiduciary, safekeeping, asset management and servicing. In September 2020, Wyoming granted the first charter for the special-purpose bank to Kraken Financial, which will be involved with cryptocurrency assets. While any deposits are not federally insured by the FDIC, this appears to make the company the first "digital bank" and provides access to the payment systems.

### *3. Pennsylvania—Technology Provider Does Not Require License*

In good news for technology service providers, a Pennsylvania court decided that the provider of technology that provided information about the transmission of money but did not actually engage in the transmission of money was not required to have a money transmitter license under the state's Money Transmitter Act.[515] The technology collected payment information and sent it to a processor. While there was transmission of information related to the payment process, that type of transmission was not the transmission of the money itself according to the court ruling. The court proceeding was in response to the state regulator's action against the company to obtain a license as being an

511 NEV. REV. STAT. § 675.

512 NEV. REV. STAT. § 675.090.

513 The drafting of S. 161 was somewhat confusing as it defined the term "Internet Lender" but intended this to cover only those entities subject to licensing relating to commercial loans. This was clarified by an Order of the Department of Business & Industry Financial Institution Division on June 26, 2020, stating that the exemption applied only to commercial loans, not to consumer loans.

514 H.B. 74.

515 *Givelify LLC et al. v. Pa. Dep't of Banking and Fin.,* Case No. 329 CD 2018 (Pa. Commw. Ct. 2019).

indispensable part of the money transmission process. But the company never touched any money itself so was found not to be subject to the requirements of the statute.

### *4. California—Significant Regulatory Events*

As California is a large, populous state, its regulation affects most marketplace lenders.

In September 2020, California enacted the California Debt Collection Licensing Act.[516] The law became effective January 1, 2022, and requires licensing by the DFPI of any person or entity engaged in debt collection with California residents, including those collecting debt on their own behalf.[517] The scope of the law is quite broad and covers any act or practice in connection with the collection of consumer debt. In addition to fee, reporting, and surety bond requirements, licensees must develop policies and procedures compliant with the law and be subject to examination. It is emphasized that this law requires a license for lenders collecting their own debt (*i.e.,* first-party collection activity).[518] It would also cover entities that are servicing loans for others, including platforms that engage in servicing for Funding Banks, investors, or loan assignees. This law is a reminder that participants in marketplace lending may be subject to various state licensing requirements in order to market, purchase, or service loans.[519]

On October 22, 2024, the DFPI issued regulations that will require registration beginning in February 2025 of debt settlement providers, post-secondary education financing entities, student debt relief providers, and income-based advances, including earned wage access.

#### *a. California Requires Licensing for "Buy Now Pay Later" (BNPL) Programs*

A current "rage" in online shopping is providing the option of "buy now pay later," or BNPL. This was a concept that became quite popular in Australia and has found its way to the United States. In the typical scenario, a purchaser is able to split the purchase price (without incurring any interest charges) into up to four installments. The primary reason for this is that the federal Truth in Lending Act and its disclosure obligations only apply to situations where either a finance charge is imposed or the deferral of payment is incurred in more than four installments.[520] The business model provides for retailers to be paid upfront, which is attractive to them and similarly appealing to consumers who can purchase products

516 S. 908, codified at CAL. FIN. CODE § 100000 *et seq*.

517 A separate California law remains applicable to the practices of those collecting debt: the California Rosenthal Fair Debt Collection Practices Act. CAL. CIV. CODE § 1788 *et seq*.

518 FDIC-insured banks including out-of-state banks and California Financing Law licensees are excluded from the requirement of obtaining a debt collection license. But the law allows the DFPI to take action against exempt entities for violations of the debt collection practices law.

519 There is a discussion of licensing in the "Regulatory Issues" section of this book.

520 12 C.F.R. pt. 1026.1(c).

without making full payment. While some of the providers claim that these are not loans, California has taken a contrary position.

On December 19, 2019, the Department of Business Oversight (the *"DBO"*), now called the Department of Financial Protection and Innovation (*"DFPI"*), the California regulator, issued a pronouncement in response to a request that BNPL products (referred to as *"deferred payment products"*) were loans requiring a license to conduct a BNPL business under the California Financing Law.[521] The state maintained that the BNPL product consisted of an online contract where a customer is delivered a sum of money and agrees to pay it back at a future time. That meets the definition of a loan under California Civil Code § 1912. The letter did not find any exemptions that would be applicable.

In September 2019 a BNPL company applied to the DBO for a California Financing Law license. Upon investigation, the DBO found that the company had already been engaging in transactions without a license and initially denied the license application on December 30, 2019. The BNPL company asserted that the transactions constituted credit sales which under California law are not loans. The DBO found otherwise. Where the role of third-party financing parties is extensive, substance trumps form and the credit sale constitutes a loan. The DBO found that the BNPL company marketed financing prior to any shopping and that the credit arrangement was with the BNPL provider not the retail merchant. Therefore it was a loan. However, the state and the BNPL provider came to a settlement where the BNPL company was fined over $28,000 for operating without a license and required it to refund some $282,000 to 17,000 customers representing fees charged in the transactions the DBO deemed to be illegal. In addition, the BNPL company was required to obtain a California Financing Law license.[522]

In March 2020 the DBO entered into a similar consent order with another BNPL company for similar violations, obtaining a fine of over $90,000, exacting customer refund of late fees of over $900,000 and requiring licensing of the company.[523] Similarly, in April 2020, the DBO and another BNPL company entered into a consent order.[524] There, a fine of $68,556 was extracted plus 10% of late fees paid by customers and customer refunds were mandated of over $685,000. Again, licensing was required.

BNPL companies as well as other financing participants should be aware of these developments by the California DBO. Where third-party involvement with a merchant goes beyond something needed to purchase credit sales, as is generally the case with BNPL programs, California (and perhaps other states as well) will treat these as loans. California will also find a loan if the role of the third party or terms of

521 Cal. Dep't Bus. Oversight Op. 7667 (Dec. 20, 2019) (Deferred Payment Products), https://dbo.ca.gov/wp-content/uploads/sites/296/2019/12/Deferred-Payment-Products-cfl.pdf/.

522 In re Sezzle, Inc., No. 60DBO-104155 (Cal. Dep't Bus. Oversight Jan. 6, 2020) (Consent Order), https://dbo.ca.gov/wp-content/uploads/sites/296/2020/01/settlement-sezzle.pdf/.

523 In re Afterpay*s* US Inc. (Cal. Dep't Bus. Oversight Mar. 16, 2020) (Consent Order), https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/03/afterpay-settlement.pdf/.

524 In re Quadpay, Inc. (Cal. Dep't Bus. Oversight Apr. 22, 2020) (Consent Order), https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/04/Quadpay-Consent-Order-Final.pdf/.

the transaction are not fully disclosed to consumers or where the third party does not bear the full risk of non-payment.

### *b. California Creates Mini-CFPB*

On the last day of August 2020, the California Legislature passed Assembly Bill 1864. This legislation creates a new consumer protection regime and changes the name of the financial regulator (the DBO, or Department of Business Oversight) to the Department of Financial Protection and Innovation (the *"DFPI"*).

It has been dubbed a "mini-CFPB" in part because one of the architects of the law was former CFPB Director Richard Cordray and one of the law's major tenets is giving the new agency UDAAP (unfair, deceptive and abusive acts and practices) authority. The agency could define what is abusive and, unlike its federal counterpart, it has authority over commercial financing transactions such as merchant cash advances, factoring, and leasing. The law also expands the enforcement power of the agency and allows additional penalties. Financial institutions and existing licensees would be exempt from the law, but new licensees would not. This sets up a dual system applicable to when one became a California licensee.

Another provision would require registration as prescribed by the agency to companies that are not currently subject to any requirements such as technology service providers, credit reporting agencies, payment processors and providers of ancillary products and services. California enacted a law to require licensing of debt collectors which became effective on January 1, 2022. Since the agency would be funded by fines and settlements or judgments, it is anticipated that an aggressive posture will be taken in order to impose and collect such penalties.

***Other Licensing Considerations.*** The issue of licensing is always relevant to marketplace lenders. As discussed earlier, licensing may be required of marketplace lenders in order to market, service or take assignment of loans. These licensing requirements are imposed regardless of whether the marketplace lender is acting on its own or on behalf of a Funding Bank. Although licensing is based on the laws of the individual states, some recent cases have addressed licensing issues and have sought to expand licensing to other participants in marketplace lending transactions.

> Marketplace lenders must assess their business model in order to adhere to applicable state licensing requirements.

One question that often arises in marketplace lending is whether loan purchasers, investors or securitization trusts need to be licensed under state law. This issue arose in Maryland, where the question was raised whether securitization trusts needed to be licensed as state collection agencies. In August 2018, the Maryland Court of Appeals determined that the state collection agency law does not

require a statutory trust acting as a securitization vehicle to obtain a license as a debt collection agency, overturning contrary decisions of the lower courts.[525]

Conversely, a debt collector who purchased defaulted loans moved to dismiss a complaint claiming that it needed to be licensed as a consumer lender under New Jersey law. The New Jersey statute contains language stating that one who directly or indirectly engages in the business of buying notes must be licensed as a consumer lender. On that basis, the action was not subject to dismissal.[526]

In yet another action against CashCall, New Hampshire issued a cease-and-desist order for lending without a license. CashCall filed a motion to dismiss which was denied and appealed to the New Hampshire Supreme Court. The state court found that the Department of Banking had jurisdiction over CashCall. The Department denied a motion to transfer the action to state court and is proceeding against the payday lender for failure to hold a license.[527]

***Lending on Digital Asset Collateral.*** Recently, some digital asset[528] businesses, many of which operate primarily or solely online, have desired, attempted, or engaged in lending to their digital asset customers, typically on a secured basis, at some percentage of their digital asset account balance, and secured by the digital asset as collateral.

We note that programs related to lending, even if secured by underlying digital asset accounts, remain subject to all applicable lending laws and regulations. In the consumer realm, such programs are subject to the licensing, usury and consumer protection law requirements described in this book.

Other new and innovative programs are likely to emerge that will raise novel legal issues or require the application of existing law to those new activities.[529]

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525 *Blackstone v. Sharma*; *Shanahan v. Marvastian*; *O'Sullivan v. Altenburg and Goldberg v. Neviaser*, Case No. 040, Sept. Term 2017 (Md. Ct. App. Aug. 9, 2018) (consolidated cases dealing with mortgage servicing).

526 *Tompkins v. Selip & Stylianou LLP et al.,* Case No. 2:18-cv-12524 (D.N.J. Feb. 11, 2019) (dismissed by Court Order Aug. 14, 2019). *See also, Barbato v. Greystone Alliance, LLC et al.,* 916 F.3d 260 (No. 18-1042) (3d Cir. Feb. 22, 2019). There the court found that a debt buyer who outsources collection activities to a third party is still a debt collector under federal law. Although not dealing with online lending per se, this case stands for the proposition that one who meets the definition of a debt collector may need to be licensed under state law even if it outsources collection activities to a third party.

527 *In re State of New Hampshire Banking Dep't v. CashCall, Inc. et al.,* 2018 WL 3570104 (N.H. Banking Dept. Case No. 12-308 June 14, 2018). The parties entered into a settlement in March 2019 requiring payment of a fine of over $188,000 and customer restitution to recast loans at a 36% APR.

528 We use the term "digital asset" to describe a broad set of digital representations of value or rights. Generally speaking, we are referring to cryptographically secured assets that include cryptocurrencies, which are mediums of exchange native to a blockchain or similar distributed network, and cryptographically secured tokens launched on top of such networks. For example, bitcoin is a cryptocurrency network, while the "initial coin offerings" made somewhat popular in 2017 were largely tokens issued through smart contracts on the Ethereum network.

529 For example, a fintech startup claimed that it would offer savings and checking accounts that would be federally insured by the Securities Investor Protection Corp. This was not true as SIPC covers only brokerage accounts and not savings or checking accounts. The program was abandoned as a result.

Digital asset lending requires compliance with applicable laws including licensing and usury.

## VII. SUPREME COURT DECISIONS OF SIGNIFICANCE

During the 2023–2024 Supreme Court session, some decisions were rendered that may impact marketplace lending programs. Some more significant ones are briefly described here.

### A. Arbitration

Many loan programs, including online lending programs, utilize an arbitration provision as the preferred method of resolving disputes. The United States Supreme Court decided a case dealing with arbitration.[530] The issue to be decided due to a split of decisions in the federal circuits was whether litigation should be automatically stayed during the appeal of a court denial of a motion to compel arbitration. In part the rationale is that a stay would avoid steep costs on defendants in class action litigation to continue litigation when a motion to compel arbitration is being appealed. Conversely, plaintiffs claimed that they are disadvantaged if they have to wait months or years to proceed with their case. The Supreme Court held that the underlying case must be stayed during the appeal process.

The Supreme Court considered a similar issue in its most recent term and held unanimously that the Federal Arbitration Act compels a court to stay (rather than dismiss) the suit pending arbitration.[531] As a result, where arbitration occurs, a court action should be stayed, but not dismissed.

### B. Deference to Federal Regulators Overturned—the Chevron Doctrine

In 1984, the Supreme Court decided a case involving Chevron which ruled that courts must defer to a governmental agency's interpretation of an ambiguous statute if it is reasonable.[532] This became known as the Chevron doctrine and gave interpretations by regulatory bodies significant weight in court actions and challenges. However, the Supreme Court overturned this doctrine as unworkable in June 2024.[533] Rather, the Supreme Court in a 6-3 decision found that courts should determine independently whether agency action was within their authority and that courts need not defer to agency interpretations. This is a significant decision and upends the certainty that has typically been afforded to agency actions. As a result, it is anticipated that more challenges will be made to agency guidance

530 *Coinbase, Inc. v. Bielski*, Case No. 22-105 (U.S. Sup. Ct.), 599 U.S. ___ (2023). The crypto customer alleged that a scammer stole money from his Coinbase account and he sued the company for failure to investigate or recredit his account under the Electronic Funds Transfer Act.

531 *Smith et al. v. Spizzirri et al.,* 601 U.S. ___ (2024).

532 *Chevron U.S.A., Inc. v. NRDC,* 467 U.S. 837 (1984).

533 *Loper Bright Enter. et al. v. Raimondo et al.,* Case No. 22-451, 603 U.S. ___ (2024).

and regulations and that uncertainty as to the validity of those measures will make compliance more difficult for all parties, including Funding Banks and participants in the marketplace lending industry.

### C. Statute of Limitations

In July 2024 the Supreme Court decided a case dealing with the statute of limitations applicable to agency actions such as the promulgation of new rules.[534] Most courts previously had found that the statute of limitations to challenge an agency action accrued from the date of the agency action, such as the promulgation of a rule. The Supreme Court, however, decided differently and ruled that the statute of limitations runs from the date of the injury to the plaintiff. This ruling aids new entrants to an industry and extends the time agency actions will be subject to challenge. Again, this ruling may promote increased litigation challenging agency actions far into the future.

## VIII. CONSUMER PROTECTION LAWS

Internet platforms must comply with a number of different federal and state consumer protection laws. Generally, these laws (i) require lenders to provide consumers with specified disclosures regarding the terms of the loans and/or impose substantive restrictions on the terms on which loans are made, (ii) prohibit lenders from discriminating against consumers on the basis of certain protected classes, and (iii) restrict the actions that a lender or debt collector can take to realize on delinquent or defaulted loans. In addition, the Dodd-Frank Act significantly changed the regulation of the consumer credit market by establishing the Consumer Financial Protection Bureau, which can bring enforcement actions for unfair, deceptive, or abusive acts or practices. Since marketplace lending is Internet-based, special consideration must be given to legal requirements that allow for electronic contracting and consent to receive disclosures electronically and requirements related to customer authorization for making payments electronically from their bank accounts. This section discusses some of the principal consumer protection laws that marketplace lenders will need to consider for program regulatory compliance purposes.

### A. Truth in Lending Act

The federal Truth in Lending Act (*"TILA"*) and its implementing Regulation Z[535] require lenders to provide borrowers with standardized and understandable information concerning certain terms and conditions of their loans and certain changes in the terms of the loans.[536] The TILA disclosure

534 *Corner Post, Inc. v. Bd. of Governors of Fed. Reserve Sys.,* Case No. 22-1008, 603 U.S. ___ (2024).

535 15 U.S.C. § 1601 *et seq.* and 12 C.F.R. pt. 1026.

536 Different disclosures are required for closed-end (installment) loans than for open-end (revolving) loans. Disclosures for closed-end loans include the amount financed (*i.e.,* the amount that the borrower will actually have use of—but not necessarily the amount of the loan), the applicable annual rate of interest expressed as an annual percentage rate, or "APR," certain other fees and charges that may be applied, and the repayment terms such as the dollar amount of each payment and the number of payments. Loans secured by real estate are subject to additional disclosure requirements and consumer protections which are beyond the scope of this book.

requirements will apply to the Funding Bank or licensed entity that is the named lender of each Borrower Loan. In addition, borrowers are generally permitted to assert some types of claims for TILA violations against any assignee of a loan, which could result in the assignee (in an Internet situation, the marketplace lender or investors as subsequent purchasers) becoming liable for TILA violations.[537] As described above, the predominant consumer Internet platform structures provide that the marketplace lender will purchase and take assignment of each Borrower Loan from the Funding Bank using funds received from the issuance of the related Platform Notes or from outside lenders or investors. Each platform and its Funding Bank therefore will need to ensure that the disclosures made to borrowers contain the information and are made in the format that TILA requires.

TILA and Regulation Z impose certain substantive restrictions and significant disclosure requirements in relation to certain other categories of loans.[538] TILA also applies to advertising of loans. Most websites are likely to be considered advertising. Thus, marketplace lenders must comply with TILA advertising requirements regardless of whether a Funding Bank is involved or not. Most important, if certain "triggering" terms are used (such as the term of a loan or interest rate), other disclosures must be made. Many Borrower Loans are installment or closed end loans. The disclosure and other requirements applicable to closed end loans are different from those that apply to revolving or open end loans. Special rules apply to private student loans, home equity loans and lines of credit and credit card products under Truth in Lending. Based on the type of loan involved, the disclosure and other requirements may differ.[539]

### B. FTC Act, UDAP Laws, and the CFPB's UDAAP Authority

Marketplace lenders must comply with Section 5 of the Federal Trade Commission Act (*"FTC Act"*),[540] which declares as unlawful any unfair or deceptive act or practice in or affecting commerce. The FTC has traditionally undertaken enforcement actions related to advertising and marketing practices. In addition, of particular importance is the Credit Practices Rule that the FTC has adopted thereunder to

537 Generally, for TILA violations to accrue to assignees, the violations must be apparent on the face of the documents; but in the case of some higher-priced loans, the liability can be broader.

538 For example, subpart F of Regulation Z mandates special disclosure requirements for loans the proceeds of which will be used to pay for postsecondary educational expenses (a *"Private Education Loan"*). Furthermore, once a Private Education Loan is offered and its terms have been adequately disclosed, the lender must allow the borrower 30 calendar days to decide whether to accept such loan. Unless a marketplace lender is establishing a lending platform specifically targeted at the student loan market and is prepared to comply with the additional disclosure requirements and to allow the borrower a 30-day window in which to accept any proffered funding, the lender should require each borrower to represent that he or she will not use his or her loan to pay for tuition, fees, required equipment or supplies, or room and board at a college, university, or vocational school.

539 A full discussion of the Truth in Lending Act is beyond the scope of this book. However, all online lending programs will be subject to this law and care should be taken to ensure compliance since even technical violations can lead to the imposition of statutory damages, actual damages, attorneys' fees and costs, all of which in the aggregate could be significant.

540 15 U.S.C. § 45.

protect consumers against abusive terms and conditions in credit contracts. Among other requirements, the Credit Practices Rule prohibits loan agreements from including terms that:

- Require the borrower to generally waive the right to notice and an opportunity to be heard in the event of a lawsuit (confession of judgment clauses);
- Require the borrower to waive the benefit of any laws that protect the consumer's real or personal property from seizure or sale to satisfy a debt (waiver of exemption);[541]
- Assign to the creditor the borrower's wages or earnings unless (a) the borrower may revoke the assignment at any time, (b) the assignment is a preauthorized payment plan established at the time the debt is incurred, or (c) the assignment applies only to wages or earnings already earned at the time of the assignment; or
- Pyramid late charges (*i.e.,* impose multiple late charges based on a single late payment).

Marketplace lenders will need to confirm that the loan agreements used to document the Borrower Loans conform to the applicable requirements of the Credit Practices Rule.

> **Caution:** A variety of marketing or servicing practices could be found to be unfair and deceptive based on the facts and circumstances of the situation. For example, placing important provisions (such as an arbitration provision, an E-Sign or electronic funds transfer consent, or even a power of attorney authorizing the lender to sign documents on behalf of the borrower) in long documents without calling attention to them—instead of placing them in separate, clear, and conspicuous formats—could be subject to challenge as an unfair or deceptive practice. Not providing opt-outs or failing to make them clear and conspicuous could also be subject to challenge under the FTC Act.

Marketplace lenders, Funding Banks, and loan servicers may also be required to comply with certain state laws that prohibit unfair and deceptive acts and practices (*"UDAP Laws"*). Some provisions of UDAP Laws that may be applicable to marketplace lenders include specific disclosure requirements related to the terms of loans, prohibitions on excessive prepayment penalties, and the availability to borrowers of certain causes of action and remedies.[542]

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541 A contractual waiver is not prohibited if it is restricted to property pledged as collateral for the debt.

542 The Dodd-Frank Act provides that state consumer financial laws shall be deemed preempted for national banks only if the applicable state law (i) discriminates against national banks in comparison to its effect on banks chartered in that state, (ii) is preempted by a federal law other than the Dodd-Frank Act, or (iii) "prevents or significantly interferes with the exercise by a national bank of its powers." The standard may make it difficult for national banks to challenge UDAP Laws on the basis of federal preemption unless a federal statute provides for preemption. In this regard, each of TILA, ECOA, and EFTA includes its own standard for preemption of state laws. In 2024, the U.S. Supreme Court reaffirmed that preemption decisions are to be based on these standards relating to prevention or significant interference.

The Dodd-Frank Act mandated the establishment of the Consumer Financial Protection Bureau and authorized the CFPB to adopt rules prohibiting unfair, deceptive, and abusive acts or practices (*"UDAAP"*) within the consumer finance market under (amongst other laws) TILA, ECOA, FCRA, FDCPA, and EFTA (each as defined below). The CFPB has not issued regulations regarding unfair, deceptive, or abusive practices, but it has articulated certain standards to assist entities in identifying whether an act or practice is unfair, deceptive, or abusive.[543] In addition, the CFPB has used enforcement actions to articulate its UDAAP standards and define the scope of that authority. The CFPB has attempted to characterize the abusive standard as one where consumer harm outweighs consumer benefit, and the current CFPB is embarking on an activist agenda with respect to UDAAP.

***Case in Point—Prefilled Drop-Down Box***. In May 2015, the CFPB filed a complaint and consent order in the U.S. district court in Maryland against PayPal, Inc., and its subsidiary, Bill Me Later, Inc., related to unfair and deceptive practices in the financing of Internet-based purchases.[544] One of the practices the CFPB complained of was the prefilling of drop-down boxes by the companies. The use of such prefilled drop-down boxes resulted in customers being signed up for financing or payments that they did not want or intend. This CFPB enforcement action served as guidance that in documents, forms, and disclosures on a website or Internet platform, boxes should not be prefilled or pre-checked but should rather allow the borrower to make an informed and independent choice after full disclosure of the options.

### C. Fair Lending and Related Laws

***Equal Credit Opportunity Act.*** The Equal Credit Opportunity Act (*"ECOA"*)[545] prohibits lenders from taking any action related to any aspect of a credit transaction, including making any credit determination, on the basis of the applicant's race, color, sex, age (except in limited circumstances), religion, national origin, or marital status; the fact that all or part of the applicant's income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under

543 The CFPB has indicated that an act or practice is unfair if: (1) it causes or is likely to cause substantial injury to consumers, (2) the injury is not reasonably avoidable by consumers, and (3) the injury is not outweighed by countervailing benefits to consumers or to competition. A representation, omission, act, or practice is deceptive if: (1) the representation, omission, act or practice misleads or is likely to mislead the consumer; (2) the consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and (3) the misleading representation, omission, act, or practice is material. An abusive act or practice: (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service, or (2) takes unreasonable advantage of (i) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; (ii) the inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or (iii) the reasonable reliance by the consumer on a party to act in the interests of the consumer.

544 Among other things, the complaint alleged that the firms illegally signed up customers for their online credit products, engaged in misleading advertising, signed up customers without their permission, and in some cases made customers use their service rather than their preferred method of payment. The action resulted in $25 million in penalties.

545 15 U.S.C. § 1691. Regulation B implementing the ECOA is found at 12 C.F.R. pt. 1002.

the federal Consumer Credit Protection Act or any applicable state law (*"Prohibited Bases"*).[546] The ECOA applies during all aspects of the credit transaction, including advertising, the application and approval process, and servicing and collection activities. For example, a lender's credit scoring systems must not be discriminatory. When determining whether to approve or deny a loan application, a creditor may use either an empirically derived and demonstrably and statistically sound credit scoring system, a judgmental system, or a combination of the two. The lender must validate and periodically revalidate its credit scoring system to ensure that it does not have a disparate impact on protected classes. In addition, if an applicant is denied credit or the cost of credit is increased, the ECOA requires that the lender provide an adverse action notification to the applicant.

Since marketplace lenders are very much involved in many aspects of the credit transaction, they must structure and operate their lending platforms in compliance with the ECOA and applicable state law counterparts.[547] In addition, the criteria used to determine creditworthiness must not have a disparate impact on the basis of any Prohibited Basis.[548] Notably, the ECOA applies to commercial as well as consumer lending. Regulators including the CFPB are extensively scrutinizing fair lending practices.

***Fair Lending—Loan Purchasers.*** Although not an action involving marketplace lending, a recent Fifth Circuit decision may have positive implications for purchasers of marketplace loans.[549] Discrimination claims under the Equal Credit Opportunity Act (*"ECOA"*) were brought against Wells Fargo as a purchaser of loans made by AmeriPro Funding, Inc. Wells Fargo would not purchase loans that were made to borrowers receiving public assistance as income, and the plaintiffs alleged that this practice

546 Various state laws may also provide for additional categories of protected classes that may not be used as a basis for determining whether to grant or refuse credit.

547 As an example, the ECOA and Regulation B thereunder generally will prohibit marketplace lenders from requesting certain types of information from borrowers including the borrower's race, color, religion, national original, or sex (*"Prohibited Information"*). To reduce the risk of violations of the ECOA (or similar state laws), lenders should prohibit prospective borrowers from posting Prohibited Information in their loan requests and should require lenders to represent that they will not base any funding decisions on Prohibited Bases. Lenders similarly should adopt internal policies intended to ensure that they do not assign proprietary credit scores, make loan servicing decisions, or take any other actions affecting lenders or borrowers on the basis of Prohibited Bases. Some state laws expand the scope of a prohibited basis such as to handicapped individuals.

548 The ECOA is not limited to consumer loans but also applies to commercial loans, including whether a guarantor on a commercial loan is acceptable if required to approve that loan. The one area where the CFPB has jurisdiction over commercial lenders is in the enforcement of the ECOA. The CFPB stated that one of its goals for 2017 was to enforce fair lending in the small business lending sector. Under Section 1071 of the Dodd-Frank Act, the CFPB is also charged with writing rules on data collection on small business loans. This is potentially similar to the data collection for consumer loans under the Home Mortgage Disclosure Act, ostensibly to identify whether there is discrimination in lending to women and minorities and on any other Prohibited Basis. The CFPB changed consumer rules to enlarge the amount of data collection required under that law. For commercial lenders, including marketplace lenders, the potential impact is at least twofold. First, systems will need to be developed and implemented to collect the data the CFPB will require. Second, as with the consumer data, such data will be publicly available, and in the case of consumer lending such publicly available data has led to litigation. Since the ECOA is designed to be neutral, the collection of data is potentially in conflict with the law. To alleviate this concern, the persons collecting the data must be separate from anyone involved in the underwriting or credit decision process. This rule will undoubtedly pose some compliance challenges for commercial lenders.

549 *Alexander v. AmeriPro Funding, Inc.,* No. 15-20710 (5th Cir. 2017), *cert. denied,* U.S. No. 16-cv-01395 (Nov. 6, 2017).

violated the ECOA. The CFPB participated in the case and advocated that the ECOA covers secondary market players such as loan purchasers. However, the Fifth Circuit disagreed. While the plaintiffs could sue AmeriPro Funding as the creditor, the court ruled that they could not bring ECOA claims against a loan purchaser based on an arm's-length transaction in the secondary market. The U.S. Supreme Court declined to hear an appeal of the case. This decision potentially protects secondary market loan purchasers from claims asserted under the ECOA.

An online lender entered into a settlement with the Department of Housing and Urban Development in connection with alleged violations of the Fair Housing Act.[550] The lender was accused of failing to make loans because the real properties at issue were located on Indian reservations and therefore constituted discrimination under fair lending laws based on race. The online lender paid a penalty of $240,000 and agreed to revise policies and practices concerning doing business with property located on Indian reservations.

***Fair Credit Reporting Act.*** When reviewing a loan application, a marketplace lender will typically rely on a "consumer report" as defined in the federal Fair Credit Reporting Act.[551] Often, this will be a credit report or score from a credit reporting agency or credit bureau. The FCRA specifically applies to users of consumer reports; thus, if a lender uses consumer reports, the FCRA will be applicable. FCRA requirements include certain restrictions on obtaining and/or using consumer reports, specific notice requirements if the terms of a loan are less favorable than the terms provided to other borrowers (risk-based pricing notice), restrictions on sharing customer information with affiliates and third parties, and implementation of an identity theft prevention program. Similar to the ECOA, the FCRA requires a lender who rejects a borrower's loan application for any reason to send the borrower an adverse action notice that discloses specified information. In addition, the FCRA imposes certain requirements that lenders must observe in reporting loan delinquencies or defaults to credit reporting agencies. Lenders must review the FCRA requirements and should consult legal counsel regarding their obligations under the FCRA to ensure that their program is in compliance.

***Case in Point—"Hard" vs. "Soft" Credit Inquiries.*** In August 2016, a California federal judge approved a $2.4 million settlement in a class action lawsuit against Social Finance, Inc., an online lender.[552] The complaint alleged that the lender claimed only soft credit inquiries (which generally do not affect a

550 "Conciliation Agreement" in FHEO Title VIII Case Nos. 08-17-5267-8 and 08-18-6949-8.

551 15 U.S.C. § 1681; 12 C.F.R. pt. 1022. Under the law, a person must have a "permissible purpose" to obtain a credit report on a consumer. While typically a loan application provides that permissible purpose, inquiries to credit reporting agencies prior to making an application may be subject to scrutiny or challenge. Typically, lenders are also furnishers of information to the credit bureaus and the FCRA imposes obligations upon the complete and correct furnishing of information. Obligations are also imposed related to inquiries or disputes of credit bureau information and the correction thereof. These issues have become of greater importance as several notable data breaches have occurred which have potentially compromised customer personal or credit information. Issues can also arise when platforms are accessing consumer report information on behalf of Funding Banks requiring authorization for those service providers to obtain that information. A full discussion of this law, as with other consumer protection laws, is beyond the scope of this work.

552 *Heaton v. Soc. Fin., Inc.*, Case No. 14-cv-05191-TEH (N.D. Cal. 2016).

credit score) would be made on the applicants, when in fact hard inquiries were made (which can negatively affect credit scores). The action was based on the FCRA and similar California laws.

***Use of Alternative Data for Credit Underwriting***. Looking beyond more traditional sources of information like consumer reports, the Internet provides access to new sources and types of information on credit applicants, including through social media channels. It has been widely reported that some lenders are using information obtained from social media to determine the creditworthiness of loan applicants.[553]

Incorporating the use of social media data into a lender's underwriting criteria raises fair lending compliance issues. A lender that desires to use social media data in its credit scoring system must establish that the data used is predictive of an applicant's creditworthiness. If social media data is used as a basis to deny an application, the adverse action notification needs to reflect that. Lenders need to ascertain whether the information obtained from social media channels is accurate and reliable since such channels are not consumer reporting agencies subject to FCRA requirements and confirm that their use of social media data in credit decisions will not result in an unfair, deceptive, or abusive act or practice. Further, lenders should ensure that unfair treatment does not occur for applicants who do not use social media.[554] Finally, a lender that uses social media data may obtain information about an applicant that it is prohibited from acquiring and using as part of its credit decision under the ECOA, thereby impacting its fair lending compliance.

***Spokeo, Standing and Actual Harm.*** In 2016, the U.S. Supreme Court ruled in the *Spokeo* case that in order to have standing to sue, a plaintiff must have suffered a concrete, particularized injury from the alleged statutory violation.[555] The Supreme Court remanded to the Ninth Circuit to determine if the plaintiff, whose claims were based on violations of the Fair Credit Reporting Act (*"FCRA"*), had suffered such an injury so as to confer standing to sue. In August 2017, the Ninth Circuit on remand found that the mere placement of incorrect information about a person in a consumer database did in fact constitute a concrete injury and violated the FCRA.[556] Spokeo appealed the Ninth Circuit's decision to the Supreme Court, but the Supreme Court denied the petition without comment.

> **Why It Matters:** The issue of standing is important in the context of consumer protection statutes because many are technical in nature, and clarifying what is required in order to demonstrate a concrete injury could have the effect of limiting the

553 The CFPB has not issued guidance on the use of social media in the context of access to credit but has stated that creditors must "ensure that their scoring models do not have an unjustified disparate impact on a prohibited basis."

554 The ECOA issues presented by social media should be addressed in credit policies and procedures to ensure that use of social media data is consistent and verifiable, that exceptions are managed, that underwriting is both predictive and fair to customers without a social media presence, and that adverse action notifications correctly reflect social media usage.

555 *Spokeo, Inc. v. Robins,* 136 S. Ct. 1540 (2016), *as revised* (May 24, 2016).

556 *Robins v. Spokeo, Inc.*, 867 F.3d 1108 (9th Cir. 2017), *cert. denied,* 138 S. Ct. 931 (Jan. 22, 2018).

> claims that plaintiffs may bring against lenders and other providers of consumer financial products and services.

The doctrine of standing as espoused by the *Spokeo* decisions has been litigated in numerous consumer protection statute cases, even with virtually the same facts resulting in conflicting decisions.[557] The amount of litigation related to standing is staggering and appears in many, if not most, consumer finance cases.[558] Following the Ninth Circuit's remand decision, plaintiffs will continue to assert that a technical statutory violation is injury enough to allow the bringing of the lawsuit. Defendants will continue to claim that something more, *i.e.,* an actual injury to the plaintiff, is required to create standing to sue. The saga will undoubtedly continue until the Supreme Court decides to take up the question of standing.

*Further Thoughts on* Spokeo*, Standing and Actual Harm under Consumer Protection Statutes*. As summarized above, the *Spokeo* decision made ripples in the industry—though the ripples were not as large as some may have hoped. The central issue in *Spokeo* was whether the plaintiff had standing for a claim under the Fair Credit Reporting Act if he could not show that any actual harm arose from the alleged statutory violation. While the Supreme Court ultimately answered this question in the negative, its holding was narrow and thus unlikely to have the effect of limiting potential claims under a variety of consumer protection statutes—particularly those that are often the basis of class actions.[559]

The plaintiff alleged that Spokeo, a data aggregator that operates a people-search engine, reported false and inaccurate information about him—specifically, that he was better educated and more highly paid than was in fact true—and thereby violated the FCRA. The district court dismissed the plaintiff's putative class action case on the ground that he lacked standing because he could not show any actual harm that arose from the alleged FCRA violation. The Ninth Circuit reinstated the case, which ultimately made its way to the Supreme Court. In its decision, the Supreme Court explained that to have standing,

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557 Employers will often ask prospective employees to provide a credit authorization to obtain a credit report. The FCRA requires that such a provision be contained in a separate, standalone document. In a situation where an employer provided the authorization along with other information, a technical violation of the FCRA, one circuit court has found the practice permissible and that the technical violation would not convey standing to sue. *See, Groshek v. Time Warner Cable,* 685 F.3d 864 (7th Cir. 2017). Meanwhile, another circuit on virtually identical facts has found that the statutory violation will result in injury and standing. *See, Syed v. M-I, LLC,* 846 F.3d 1034 (9th Cir. 2017). Note: As employers, marketplace lenders should review the FCRA to ensure that the practices they employ to obtain credit authorizations from prospective employees comply with the statute.

558 Standing is often an issue when there has been a data breach, potentially resulting in the compromise of personally identifiable nonpublic information. Again, there are conflicting court opinions. One federal circuit holds that the breach itself results in injury because there is a risk of being subject to identity theft, which is sufficient to bring a claim. *See, In re Horizon Healthcare,* 2017 WL 242554 (3d Cir. 2017). Another circuit has found that there must be allegations or proof that the data is in fact at risk, *i.e.,* the breach itself is not enough to convey standing. *See, Gubala v. Time Warner Cable, Inc.,* 2017 WL 243343 (7th Cir. 2017). Given recent large data breaches, these issues can be of material importance to the companies involved.

559 Many of these statutes affect marketplace lenders, including the Truth in Lending Act, the Electronic Funds Transfer Act, the Fair Credit Reporting Act, and the Telephone Consumer Protection Act.

a plaintiff must show (among other things) an "injury in fact" from the particular allegation. The court emphasized that the injury must be both "concrete and particularized," though it need not be tangible. With this ruling, the court sent the case back to the Ninth Circuit to determine if the plaintiff had actually alleged the kind of injury that would allow his suit to proceed.

Because *Spokeo* did not create any new law and simply restated the requirements for standing, it has not been able to be applied in the way many companies had hoped. Courts have been inconsistent in applying *Spokeo* to a number of federal consumer protection statutes. For example, while in some instances TCPA cases have been dismissed on *Spokeo* grounds, many other courts have found sufficient injury based on invasion of privacy, or even *de minimis* costs, like the amount it costs to charge a cell phone battery drained by receiving unwanted telephone calls, or time spent answering unwanted phone calls.[560] Similarly, courts have been split when reviewing Fair Debt Collection Practices Act (*"FDCPA"*) claims, where some courts have asserted that a bare FDCPA violation alone constitutes a violation of a right that Congress sought to raise to the level of a concrete injury.[561] However, many others have disagreed, requiring an additional showing of some injury.[562] The trend continues with courts reviewing TILA claims.[563]

The Ninth Circuit heard oral arguments in December 2016 on whether the plaintiff had actually alleged the kind of injury that would allow his suit to proceed. In August 2017, the Ninth Circuit issued its decision, finding that the mere placement of wrong information about a person in a consumer database constituted a concrete injury and violated the FCRA. The U.S. Supreme Court refused to hear an appeal. As a result, *Spokeo* ultimately did not bring much clarity to the question of standing in consumer protection statute cases and this issue will likely remain unsettled until further litigation resolves it. Many cases have brought both claims and defenses based on this case and it continues to be a legal issue in many consumer protection-type cases. Nonetheless, the decision provides a potential defense to claims brought under consumer financial protection laws.

***Standing.*** In many consumer finance cases, the question arises as to whether a mere violation of the statute is a sufficient enough injury to create standing to sue. This was considered in a recent Supreme

560 *Mey v. Got Warranty, Inc.*, No. 5:15-CV-101, 2016 WL 3645195, at *3 (N.D. W. Va. June 30, 2016).

561 *Church v. Accretive Health, Inc.*, No. 15-15708, 2016 U.S. App. LEXIS 12414 (11th Cir. July 6, 2016).

562 *Nokchan v. Lyft, Inc.*, No. 15-cv-03008, 2016 U.S. Dist. LEXIS 138582 (N.D. Cal. Oct. 5, 2016) ("not follow[ing] *Church*"); *Macy v. GC Servs. L.P.*, No. 3:15-cv-819, 2016 U.S. Dist. LEXIS 134421, at *8 n.3 (W.D. Ky. Sept. 29, 2016) (finding that it "does not share the *Church* panel's expansive reading of *Spokeo*"); *Dolan v. Select Portfolio Servicing*, No. 03-CV-3285, 2016 U.S. Dist. LEXIS 101201, at *20 n.7 (E.D.N.Y. Aug. 2, 2016) ("respectfully disagree[ing] with *Church*" and "reject[ing] the view that *Spokeo* established the proposition that every statutory violation of an 'informational' right 'automatically' gives rise to standing").

563 *See Jamison v. Bank of Am., N.A.*, Case No. 2:16-cv-00422-KJM-AC, 2016 WL 3653456 (E.D. Cal. July 7, 2016) (finding bare procedural TILA violation insufficient to provide standing where omitted information from payoff was provided elsewhere); *but see McQuinn v. Bank of Am., N.A.*, Case No. 14-56038, 2016 WL 3947831 (9th Cir. July 22, 2016) (noting that there is some question as to whether a violation of TILA's notice requirement under 15 U.S.C. § 1641(g), without more, creates an injury that is sufficiently concrete to confer standing, but finding sufficient concrete injury in this case).

Court decision dealing with the Fair Credit Reporting Act.[564] The plaintiff was denied a loan due to an alert placed on his credit file. The suit alleged a class of persons subject to this alert, which numbered about 8,000; however, only about 1,850 customers had these alerts disseminated outside the credit bureau. The court found that these persons had no basis to assert standing. The court ruled that if there is no concrete harm, there is no standing to sue. The court indicated that the risk of possible future harm was also not enough of an injury to create standing. FCRA actions are oftentimes brough in the context of data breach situations. Therefore, this decision may be an important precedent in either deterring or limiting litigation where there is no evidence of injury or only the potential for future harm.

***Servicemembers Civil Relief Act.*** Another fair lending consideration is the potential application of the Servicemembers Civil Relief Act (*"SCRA"*).[565] The SCRA, applicable to all lenders, limits the interest rate that may be charged on loans made to borrowers on active military duty and may require a rate adjustment on loans that were made to borrowers prior to the borrowers entering active military duty.[566] In the loan servicing context, it is important to have procedures to ensure SCRA compliance so that servicemember benefit requests are properly handled and monitored on an ongoing basis. Regulatory agencies, including the CFPB, continue to enforce the SCRA.

***Military Lending Act.*** The Department of Defense (*"DOD"*) issued a final rule imposing new requirements under the Military Lending Act, which took effect in October 2016 (the *"MLA Rule"*).[567] The MLA Rule is not specific to marketplace lending, but it applies to most unsecured consumer credit transactions and therefore implicates the practices and procedures of many marketplace lenders.

A "covered borrower" for purposes of the MLA Rule is any servicemember and his or her dependents, which includes a servicemember's spouse, children under 21, and parents or parents-in-law that live in the servicemember's home. The MLA Rule establishes a safe harbor for determining whether someone is a covered borrower by using information obtained from the DOD's MLA database or a nationwide consumer reporting agency. The covered borrower determination may also be made using other methods, such as a covered borrower self-identification statement, but there is no safe harbor in that case.

Among other things, the MLA Rule establishes a maximum "military annual percentage rate" (*"MAPR"*) of 36% for credit extended to servicemembers and their dependents. The MAPR includes certain fees that are not counted as finance charges for purposes of calculating the annual percentage rate under the Truth in Lending Act (*"TILA"*) and Regulation Z; thus, a separate calculation is necessary to determine whether an extension of credit is within this limit. With respect to covered borrowers, the MLA Rule also imposes certain disclosure requirements (including some that must be provided orally), prohibits the

564 *TransUnion v. Ramirez*, 141 S. Ct. 2190 (2021). Decided June 25, 2021.

565 50 U.S.C. § 501 *et seq.*

566 The CFPB has been aggressive in enforcing violations of the SCRA in servicing situations.

567 80 Fed. Reg. 43560 (July 22, 2015).

imposition of a prepayment penalty, and prohibits mandating arbitration in the event of a dispute. As a result, a marketplace loan will need to include a provision in its loan documents giving the required disclosure and lenders must have in place a toll-free number for covered borrowers to call for the oral disclosure. Marketplace lenders should ensure that appropriate procedures are in place to identify covered borrowers and to comply with these additional requirements when applicable.

*CFPB Expanded Oversight of Small Business Lending*. On May 15, 2017, the CFPB published a Request for Information on the small business lending market.[568] Many had speculated that the CFPB would make moves to expand its jurisdiction to small business lending, as then-Director Richard Cordray had publicly commented that his preference would be for the CFPB to protect both consumers and small businesses since both operate similarly in the marketplace.[569] The CFPB has the ability to exercise jurisdiction over small business lenders through the data collection provision mandated by the Dodd-Frank Act, which amended the Equal Credit Opportunity Act by adding a requirement for lenders to collect and maintain loan data for women-owned, minority-owned and small business credit applicants.[570] The CFPB is the sole agency responsible for overseeing this requirement for all financial institutions regardless of their size or primary regulator,[571] thus permitting CFPB oversight of smaller lenders including certain marketplace lenders that would otherwise be excluded from its ECOA enforcement authority.

The CFPB could use this data collection requirement as a means to pursue fair lending actions against small business lenders since the data could enable the agency to analyze potential disparate impacts and redlining practices. The CFPB could also use the data to influence the lending practices among small business lenders, similar to its actions in the auto finance market. Cordray never proposed any small business rules and it was not until after a lawsuit was filed that the CFPB publicly announced an outline of proposals it was considering implementing this rule in September 2020. A final rule was issued on March 30, 2023, and was challenged in court. Eventually a district court found the rule to be validly promulgated, but that ruling is on appeal to the Fifth Circuit.[572]

### D. Debt Collection Practices

Any third-party collection agents or servicers that a marketplace lender employs, and any marketplace lender who collects debts on behalf of others, must comply with the federal Fair Debt Collection

568 *Request for Information Regarding the Small Business Lending Market*, 82 Fed. Reg. 22318 (May 15, 2017).

569 The Semi-Annual Report of the Bureau of Consumer Financial Protection: Hearing Before the House Committee on Financial Services, 114th Cong. (2016) (testimony of Richard Cordray, Director, Consumer Financial Protection Bureau).

570 Section 1071 of the Dodd-Frank Act, codified at 15 U.S.C. § 1691c-2.

571 Financial institution is defined broadly as "any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization or other entity that engages in any financial activity." 15 U.S.C. § 1691c-2(h)(1). The definition covers both banks and non-banks, including online lenders that lend to applicable businesses.

572 This is further discussed in the "Recent Developments in Marketplace Lending Regulation" section.

Practices Act (*"FDCPA"*)[573] and similar laws in the applicable state when attempting to collect overdue payments from delinquent borrowers. Such laws govern how servicers and collection agents can collect overdue amounts and generally prohibit abusive, unfair and harassing debt collection practices, limit certain communications with third parties, and impose notice and debt validation requirements. For example, a servicer communicating with anyone other than the borrower in trying to ascertain the borrower's location must identify themselves (including their employer, if requested), state that they are seeking location information, and not disclose that the borrower owes a debt. Once a consumer debtor is represented by counsel, all collections communications must be with their attorney rather than with the consumer directly. Collection activities must be limited to reasonable times; the FDCPA specifies between 8:00 a.m. and 9:00 p.m. absent actual knowledge of inconvenient times. The FDCPA also requires servicers to cease further collections communications upon the debtor's request, except in very limited circumstances.

Debt collection laws are a compliance complexity and can lead to litigation. Violations of the FDCPA can lead to awards of actual damages, statutory damages of up to $1,000 in an individual action and up to $500,000 or 1% of the defendant's net worth in a class action, plus attorneys' fees and costs. Regulatory agencies can also enforce the law. As a result, marketplace lenders acting as servicers or utilizing third-party servicers need to understand and comply with the applicable debt collection laws for Borrower Loans.

A lender that acts as its own collection agent for any Borrower Loans will not be directly subject to the FDCPA but as a matter of prudence should comply with its substantive provisions and will be subject to mandatory compliance with similar laws in certain states. The lender will be directly subject to the FDCPA if it acts as a collection agent for an affiliated issuer, purchasers of the Borrower Loans, or funds. In the event a borrower files for bankruptcy, becomes the subject of an involuntary bankruptcy petition, or otherwise seeks protection under federal bankruptcy law or similar laws, a marketplace lender and its third-party collection agents must comply with the Bankruptcy Code automatic stay and immediately cease any collection efforts. See "Bankruptcy Considerations" in the Appendix A. Finally, marketplace lenders must consider provisions of the SCRA that permit courts to stay proceedings and the execution of judgments against servicemembers and reservists who are on active duty.

It should be noted that the CFPB has adopted rules setting forth its authority to supervise non-bank debt collectors that generate annual revenue in excess of $10 million from consumer debt collection activities. Even lenders whose revenues from collection activities are not sufficient to make them subject to direct CFPB supervision should consider voluntary compliance with the standards that the CFPB has established for debt collectors regulated by it.

***Proposed Rule.*** Prior to the passage of the Dodd-Frank Act no federal agency had been tasked with the job of writing regulations for the FDCPA. The Dodd-Frank Act gave that authority to the CFPB. In May

573 15 U.S.C. § 1692.

2019, the CFPB issued a notice of proposed rulemaking concerning debt collection to take into effect modern-day communications not in existence at the time the FDCPA was enacted in 1977, such as email. The proposal deals with electronic forms of communication and would prohibit more than seven calls to a debtor in a seven-day period. It would also provide forms of notices to comply with debt collection validation notices. It is hoped that codification of rules will provide additional certainty to debt collection efforts and slow the pace of litigation related to debt collection practices.

***Regulation F—Consumer Debt Collection Became Effective in November 2021.*** Although enacted in the 1970s, no regulations were written for the federal Fair Debt Collection Practices Act (*"FDCPA"*) until the 2020s, with the final regulation promulgated by the CFPB becoming effective on November 30, 2021.[574] While the regulations apply to all debt collectors, there are participants in the marketplace lending industry who are debt collectors and will be subject to this law. They could include entities that service loans and collect payments on behalf of a Funding Bank, a loan assignee, an investor, or a securitization vehicle. Some provisions of the regulations are designed to deal with modern technology that is used to collect debts, such as email or text messages. In order to use these methods, consumer consent must be obtained. The regulations also provide language that creditors should use to inform consumers they intend to share their email address with a debt collector, and the debt collector must confirm that the creditor followed the required procedures before using the email address. Consumers are also given the right to opt out of texting or email communication by notifying the creditor or debt collector. As to telephone communications, debt collectors may not call a consumer more than seven times in seven days, or within seven days of their last conversation with that consumer. Collectors may only call during specified hours (8:00 a.m.–9:00 p.m. in the consumer's time zone) and may not call at times known to be inconvenient to the consumer. If leaving a voicemail, there is a specific script that limits the information a collector may say on the voicemail.[575] Regulation F will have a significant impact on how debt collectors operate. Creditors should be sure that their arrangements with servicers and debt collectors reflect adequate coverage and protection given the new regulations. Creditors will also need to provide the prescribed notice if email addresses will be shared with debt collectors.

***Debt Buyer Is Not a Debt Collector.*** Resolving a split of opinion between several circuits, the U.S. Supreme Court ruled that an entity that buys defaulted debts is not a debt collector under the Fair Debt Collection Practices Act and therefore, not subject to compliance with that statute.[576] In Justice Gorsuch's first written opinion expressing the views of a unanimous court, he stated that debt buyers do not meet the FDCPA statutory definition of collecting or attempting to collect debts "owed or due

574 The regulation is codified at 12 C.F.R. pt. 1006.

575 A full discussion of this extensive regulation is beyond the scope of this book. The regulation does prohibit bringing or threatening to bring an action where it is known (or should have been known) that the statute of limitations has expired, and it makes it a strict liability cause of action. Regulation F also prescribes sample debt validation notices that must contain specific and expanded amounts of information. Compliance issues are likely to generate new litigation based on these new regulations.

576 *Henson v. Santander Consumer USA, Inc.,* 137 S. Ct. 1718 (2017).

to another."[577] Rather, a debt buyer is collecting on its own behalf because it owns the debt. It is possible, however, that debt buyers may still be subject to the FDCPA under other definitions.

*Use of Automatic Dialers.* The U.S. Supreme Court unanimously decided a case under the Telephone Consumer Protection Act (*"TCPA"*), narrowing the scope of autodialers subject to the law.[578] The consumer sued under the TCPA after receiving several months of text message for an account that never existed and without consent. In interpreting the definition of an automatic telephone dialing system under the law, the court found that in this instance the technology used could neither store nor produce numbers in a random sequential order as required by the statute and therefore the case was dismissed as not being subject to the TCPA definition. As a result, this effectively narrowed the devices subject to the law.

The debt collection industry was put into a tizzy when a circuit court of appeals ruled that a debt collector violated the Fair Debt Collection Practices Act when it provided its third-party mail letter vendor with customers' personal information in order to print collection letters for purposes of collecting a debt. Lenders have used mail vendors for years to send out notification letters to debtors. The plaintiff alleged that this practice was a communication about a debt to a third party, which violated the law. Numerous suits were filed as a result of this decision and some debt collection was ceased in the Eleventh Circuit states of Alabama, Georgia and Florida. That decision was later vacated and the Eleventh Circuit ruled in favor of the debt collector and dismissed the lawsuit.[579] The decision was based on the legal doctrine of standing that in order to bring a suit, a plaintiff must show a concrete injury to establish an alleged intangible harm. In this instance, there was no harm by the dissemination of information to the service provider. The Tenth Circuit similarly affirmed a dismissal of similar claims for lack of standing find that the use of an outside mail vendor does not violate the Fair Debt Collection Practices Act as there is not concrete injury.[580]

### E. Privacy Laws

Because of the personal and sensitive nature of the information that is collected from prospective borrowers, it is imperative that marketplace lenders comply with applicable laws and regulations governing the security of nonpublic personal information.[581] In particular, the federal Gramm-Leach-Bliley Act (*"GLBA"*) limits the disclosure by a financial institution[582] of nonpublic personal

577 15 U.S.C. § 1692a(6).

578 *Facebook, Inc. v. Duguid*, 592 U.S. 395 (2021).

579 *Hunstein v. Preferred Collection, Inc.*, Case No. 19-14434 (11th Cir. Sept. 8, 2022).

580 *Shields v. Prof'l Bureau of Collections of Md., Inc.*, 55 F.4th 823 (10th Cir. 2022). Both cases follow the Supreme Court holdings in *Spokeo, Inc. v. Robins*, 578 US 330 (2016), and *TransUnion, LLC v. Ramirez*, 141 S. Ct. 2190 (2021).

581 See the previous section on the FCRA which also contains requirements with respect to privacy and information sharing.

582 The GLBA governs "financial institutions," which is defined to mean any institution the business of which is engaging in financial activities as described in section 4(k) of the Bank Holding Company Act of 1956 (which includes the lending of

information about a consumer to nonaffiliated third parties and requires financial institutions to disclose certain privacy policies and practices, including with respect to the sharing of such information with both affiliates and/or nonaffiliated third parties. A privacy notification or policy must be provided at the time an account is opened and on an annual basis thereafter. If a financial institution chooses to share information with nonaffiliated third parties, borrowers must be given the right to opt out of such information sharing. States also have enacted privacy laws that may be applicable to marketplace lenders. Lenders are advised to consult with legal counsel to determine which, if any, state privacy laws may be applicable.

GLBA also requires financial institutions to establish an information security program to ensure the security and confidentiality of customer records and information, protect against anticipated threats or hazards to the security or integrity of those records, and protect against unauthorized access to or use of those records or information. In order to assist financial institutions in developing an appropriate information security program, the related federal agencies published the Interagency Guidelines Establishing Standards for Safeguarding Customer Information (*"Security Guidelines"*).[583] Due to the inherent risks associated with maintaining information that is accessible over the Internet, a marketplace lender should review the Security Guidelines in connection with the development of its information security program.[584]

Finally, GLBA requires financial institutions to develop and implement a response program designed to address incidents of unauthorized access to customer information maintained by the institution or its service provider. The related federal agencies have also published Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice. In addition, most states have laws that would require a marketplace lender to notify customers of a breach of security in which personal information is reasonably believed to have been acquired or accessed by an unauthorized person. For example, the NYDFS cybersecurity rule imposes requirements that are more stringent than those imposed under GLBA. As these laws vary from state to state in their applicability, the type of information that is covered, and the notification requirements, lenders are advised to consult legal counsel to determine the appropriate course of action should a data breach occur.

After the massive data breach at a national credit bureau, it has been anticipated that additional privacy restrictions would come into place for all lenders, including marketplace lenders. As stated previously, the U.S. Treasury report recommended that Congress enact a comprehensive data privacy and data breach law. Some legislation has been introduced in Congress to this effect, but the issue of federal

money). Marketplace lenders will most likely be deemed "financial institutions" for these purposes. The GLBA is codified at 15 U.S.C. § 6801-3809 and regulations are found at 12 C.F.R. pt. 1016.

583 Interagency Guidelines Establishing Standards for Safeguarding Customer Information (15 U.S.C. § 6801 *et seq.*) and FTC Safeguards Rule (16 C.F.R. pt. 314). The FDIC Regulation is at 12 C.F.R. pt. 364 App. B.

584 In March 2019, the FTC issued notices of proposed rulemaking to amend the GLBA privacy rules and rules related to safeguarding personal information.

preemption of state laws looms as a deterrent to enacting any legislation at the federal level.[585] In October 2023, the FTC amended the Safeguards rule to require non-bank financial entities to report data breaches affecting more than 500 people within 30 days to the FTC.

Meanwhile, some states are moving forward on these issues. As of November 2024, twenty (20) states had enacted comprehensive privacy laws.[586] California, for example, passed privacy legislation in June 2018 that took effect in 2020. In Vermont, data brokers must disclose information they collect and allow consumers to opt out. While these laws are similar in nature, they are not the same. Additional state legislation on this front is expected to continue, creating a patchwork of laws relating to data security, privacy, and breach notifications.

Although affecting many entities, privacy laws enacted in several states will also affect online lending programs. On January 1, 2023, laws in Virginia and California became effective. On July 1, 2023, Connecticut's Data Privacy Act and Colorado's Privacy Act went into effect and on December 31, 2023, Utah's Consumer Privacy Act went into effect. Sixteen (16) other states have enacted comprehensive privacy laws as of this writing. All of these laws will give consumers the right to access, delete and request their personal information. Consumers will also have the right to opt out of targeted advertising and disclosures that may qualify as sales of personal information. Operationally, lenders will be required to provide notices about information practices such as a privacy policy and will be prohibited from discriminating on the basis of exercising their privacy rights. As with commercial disclosure laws, while these laws are similar, they are not the same, so compliance will become more complicated for multistate programs.[587] Other states are considering similar legislation.

### F. State Privacy Laws—California

The California Consumer Privacy Act, or CCPA, went into effect in January 2020, final rules were promulgated June 1, 2020, and enforcement by the Attorney General began in July 2020. Although not unique to marketplace lenders, the law imposes obligations on certain commercial entities that collect consumer data including through a website. The law affects a business that either has annual gross revenues more than $25 million or annually buys, receives for commercial purposes, sells or shares personal information of 5,000 or more consumers or derives 50% or more of its annual revenues from selling consumer personal information.[588] If the CCPA is applicable, California consumers have the rights (1) to know what personal information is being collected and where it is from, and whether this

585 The FTC on March 5, 2019, published notices of proposed rulemaking to make extensive changes to the existing standards for the safeguarding of consumer information (12 C.F.R. pt. 314) and the GLBA Privacy Rule affecting privacy of consumer financial information (16 C.F.R. pt. 313).

586 These states include California, Virginia, Colorado, Connecticut, Utah, Iowa, Indiana, Tennessee, Texas, Florida, Montana, Oregon, Delaware, New Hampshire, New Jersey, Kentucky, Nebraska, Maryland, Minnesota and Rhode Island.

587 Again, a detailed analysis of these laws is beyond the scope of this missive.

588 CAL. CIV. CODE § 1798.100 *et seq*. The law also applies to any entity that controls or is controlled by an entity that meets the applicable thresholds. CAL. CIV. CODE § 1798.140.

is being disclosed or sold, (2) to prevent personal information from being sold, (3) to have personal information deleted and (4) to receive the same pricing and services even if they exercise their rights under the CCPA. Compliance with this law may be difficult and non-compliance could lead to onerous penalties.[589] Proposition 24 was on the California ballot on November 3, 2020, and passed. The Proposition encompasses four major areas: (1) it makes changes to existing privacy laws, (2) it provides for new privacy laws and consumer rights, (3) it changes penalty provisions (most notably the current ability to correct violations and avoid penalties), and (4) it creates a new state enforcement agency for privacy matters, the California Privacy Protection Agency (CPPA).

Like the state-by-state commercial disclosure laws discussed above, each of these privacy laws of the 20 affected states contain different provisions. Fast becoming another patchwork collection of state laws requiring differences in compliance operationalization, consumer privacy law is another area where federal legislation has been introduced.[590] These laws all have similarities such as when an entity becomes subject to the law, consumer consent, and/or opt-out rights of data sharing, but they take somewhat different approaches in how these issues are handled.[591] In addition, Congress is considering a uniform national standard to avoid the patchwork of state laws that appears to be developing.

### G. Electronic Commerce Laws

***E-Sign Act and UETA.*** It goes without saying that Internet loan platforms execute borrower/lender registration agreements and process credit transactions in electronic form and that virtually all payments are processed through the Automated Clearing House (*"ACH"*) electronic network. Accordingly, marketplace lenders need to comply with the federal Electronic Signatures in Global and National Commerce Act (*"E-Sign Act"*)[592] and similar state laws (particularly the Uniform Electronic Transactions Act (*"UETA"*)),[593] both of which authorize the creation of legally binding and enforceable agreements utilizing electronic records and electronic signatures and set forth certain disclosure and consent requirements.[594]

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589 The Attorney General may seek civil penalties of up to $7,500 per violation and consumers may seek the greater of statutory damages of $100 to $750 per incident or actual damages incurred. CAL. CIV. CODE § 1798.150.

590 S. 1494 Consumer Data Privacy and Security Act of 2021.

591 A discussion of the specifics of the similarities and differences of these laws is beyond the scope of this book. Whether or not the law applies and to what extent compliance is required should be looked at carefully.

592 15 U.S.C. § 7001 *et seq.*

593 Forty-nine states and the District of Columbia have adopted UETA in substantially the form promulgated by the National Conference of Commissioners on Uniform State Laws in 1999. New York has not. California has adopted UETA, but made significant variations to the model text. *See* Uniform Electronic Transactions Act: CAL. CIV. CODE § 1633.1 *et seq*. This book assumes that either UETA or the E-Sign Act (which preempts state electronic signature and records laws to the extent inconsistent with UETA) will apply to the electronic transactions discussed herein. Lenders should consult legal counsel if New York law applies to their electronic transactions.

594 However, security interests governed by Article 9 of the Uniform Commercial Code (the "*UCC*") are not subject to the E-Sign Act or UETA. See 15 U.S.C. § 7003(a)(3) and UETA § 3 (exempting certain transactions governed by the UCC, including Article

Federal consumer protection and disclosure laws allow consumers to receive legally required disclosures electronically if they consent to electronic disclosure prior to receiving the disclosure.[595] Specifically, the E-Sign Act and regulatory guidelines provide that a borrower can consent to receive electronic records only if the consent is provided electronically in a manner that reasonably demonstrates that the borrower can access the information in the electronic form that will be used to provide the information. In addition, any information required by law to be provided in writing can be made available electronically to a borrower only if the borrower affirmatively consents to receive the information electronically and the lender clearly and conspicuously discloses certain required information to the borrower prior to obtaining his or her consent.

> **Worth Remembering:** Having a proper form of E-Sign Act authorization and consent to receive disclosures electronically is crucial to the successful operation of an Internet lending platform.[596] As a result, the timing and placement of the customer's consent to electronic disclosures and contracting is important. It is a best practice to put the E-Sign consent first in a transaction as it must be obtained prior to the time that any disclosures are received or any contract is entered into. The consent should not be buried in a longer document but preferably presented as a standalone document requiring an affirmative act to show assent.

Courts are paying attention to these types of matters. For example, the Seventh Circuit held that an arbitration clause in an online terms of use, eight pages into a ten-page agreement, was not sufficient to give proper notice of the arbitration agreement.[597] In another case also dealing with an arbitration agreement, a federal court held that checking a box to confirm reading of an agreement was not enough to bind the borrower where the online lender held all of the electronic records.[598] These recent

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9 security interests, from coverage under the E-Sign Act and UETA, respectively). Also see "Bankruptcy Considerations—Security Interests in Electronic Collateral" in Appendix A for a discussion of related UCC issues.

595 It is suggested that applicants and borrowers be required to click through any legally required disclosures and terms and conditions of agreements to show that they have read the disclosures and agreements. Use of links to disclosures or legal documents poses additional risk, particularly if a link does not indicate the significance of the link. If it cannot be shown that the link was accessed, there may not be a legal basis to assert that the customer has received and read the disclosure or agreement. E-Sign requirements are also applicable to commercial lending arrangements.

596 In an Internet context, additional legal concerns can be created if more than one individual is involved in the process. For example, joint applicants or guarantors raise the issues of appropriate customer identification, E-Sign consent, and authorizations. Legal counsel should be consulted on these matters. Special issues also arise with respect to lending secured by real or personal property.

597 *Sgouros v. TransUnion Corp. et al.*, Case No. 15-1371 (7th Cir. Mar. 25, 2016). The "I Agree" button appeared below a notice that the consumer was agreeing to have its personal information viewed and that notice said nothing about arbitration. The court said that the site did not sufficiently notify customers that they were signing the agreement and consenting to arbitration. The court also stated that where terms are not displayed but must be brought up via hyperlink, there should be a clear prompt directing the user to read such terms. Contract law requires that a website provide a user reasonable notice that use of the site or clicking on a button constitutes assent to an agreement.

598 *Dillon v. BMO Harris Bank N.A.*, 2016 BL 89102 (M.D.N.C. Mar. 25, 2016).

cases demonstrate that courts are scrutinizing online programs and documentation in light of consumer protection considerations. This suggests that marketplace lenders need to provide disclosures clearly and obtain a consumer's agreement to important documents such as electronic contracts and arbitration agreements by affirmative action to effectively demonstrate their consent.

***Electronic Funds Transfers.*** With respect to electronic payments, since marketplace lenders are not typically organized as banks, they must rely on eligible financial institutions (such as FDIC-insured banks) both to fund the Borrower Loans and to receive payments over the ACH network. The Electronic Funds Transfer Act (*"EFTA"*) and its implementing Regulation E[599] establish the rights, responsibilities, and liability of consumers who use electronic fund transfers and of financial institutions and certain other parties that offer these services. These laws contain disclosure and dispute resolution requirements and require a party that wishes to automatically debit a consumer account for a payment to obtain written authorization from the consumer for such automatic transfers.[600]

> **Key Considerations:** Under the EFTA, a lender cannot require a borrower to make payments by electronic means as a condition of obtaining a loan. However, a lender may provide an incentive for making payments electronically.[601] Thus, an appropriate customer authorization for automatic debits and compliance with Regulation E are essential to Internet lending programs.[602] The authorization must be in writing and signed by the borrower, and a copy of the authorization must be provided to the borrower. As suggested by the recent cases, placing such an authorization within another document may not be sufficient to show proper consent to the electronic transfer of funds as is required by the EFTA. As a result, it is a best practice to have a separate authorization for a preauthorized transfer from a borrower's account for payment of a loan.

599 15 U.S.C. § 1693 *et seq.*; 12 C.F.R. pt. 1005.

600 The law and regulation impose certain requirements upon these authorizations. The authorization may be in a set amount (*e.g.,* the monthly payment amount) or a range (which could provide for the inclusion of late payment or other fees). However, the customer is entitled under the law to receive notice of any amounts varying from the specified transfer amount or range. The customer must also have the right to terminate the automatic payments.

601 Although it might seem proper to provide an interest rate reduction for making payments electronically, a disincentive could violate the EFTA. For example, charging a fee for paying by check could violate both the EFTA and state laws that may prohibit such fees. Litigation is pending on this subject. Care should also be taken with respect to how payment options are presented. Prefilled boxes are likely to be viewed as a potential unfair practice.

602 It should be noted that payday lenders have been subjected to regulatory scrutiny for electronic payments. The New York banking regulator instructed financial institutions not to make ACH transfers to high-rate lenders. Similarly, the Department of Justice has been criticized for "Operation Choke Point," aimed at cutting off high-rate Internet lenders from the ACH and payments systems. Several subpoenas were issued under this program and at least one bank entered into a settlement with the DOJ for processing payments for a high-rate Internet lender. Access to the payment systems for Internet lenders continues to be an evolving issue, particularly for high-rate or payday lenders.

Two courts have considered the practice of requiring the borrower to sign an electronic funds transfer (*"EFT"*) authorization for loan payments but allowing the customer to cancel at any time, even before the first loan payment is made. Both courts found this practice to be a violation of Regulation E and the EFTA. In *De La Torre v. CashCall, Inc.*, the lender used a promissory note containing an EFT authorization which included language allowing cancellation of the authorization at any time.[603] In order to comply with the signed writing requirement, the lender required the borrower to check a box indicating its authorization for EFTs. If the borrower did not check the box, it could not obtain a loan. Once the loan was funded, the borrower could cancel the authorization at any time, including prior to the first loan payment date. The court found that this practice violated the EFTA and Regulation E, which prohibit conditioning an extension of credit on repayment via EFT. The court reasoned that the violation occurs at the time the lender requires the authorization to receive the loan, notwithstanding any later ability to revoke or use another means of payment. This case was decided on a motion for summary judgment, so it was a ruling on the merits and the court ordered a hearing to determine damages on the claim. The court also found that this practice violated the California Unfair Competition Law.

Another court reached the same conclusion on similar facts. In *FTC v. Payday Financial, LLC*, the lender had an EFT authorization in its loan agreement and required borrowers to sign it in order to obtain a loan.[604] As in *De La Torre*, the borrower had the ability to revoke its authorization prior to the first loan payment. However, since the borrower had no choice but to authorize the EFT to obtain a loan, the court found that the lender had violated the EFTA and Regulation E.

Regulators are also enforcing Regulation E violations.[605] Electronic payments and compliance will continue to be an ongoing source of regulatory and judicial action.

> **Takeaways:** Based on these cases, there is a significant risk of violation of law and regulation, and the potential for UDAP/UDAAP-type claims as a result of such a practice. Our experience is that lenders are now providing choices for payment and making loans regardless of what payment option is chosen. Accordingly, any practice that does not provide a choice or payment or that prevents a borrower from obtaining a loan if it does not sign an EFT authorization under current precedent would likely be subject to challenge, litigation, and a finding of a violation.[606]

603 56 F. Supp. 3d 1073 (E.D. Cal. 2014).

604 989 F. Supp. 2d 799 (Dist. S.D. 2013).

605 The CFPB has also brought actions against an online lender (Enova International, discussed elsewhere) on the basis that an EFT authorization for one account does not transfer when the account is changed and pulling funds from a new account without a new authorization is a prohibited practice.

606 The CFPB analyzes the EFT practices of creditors for compliance with the EFTA, has issued civil investigative demands (CIDs), and considers enforcement actions related to compliance with EFTA.

***Cases Relating to Electronic Contracting.*** Given the online world in which we now live, it is no surprise that more litigation is occurring that deals with entering into contracts electronically. Some of the litigation involves whether or not a contract has been formed, and many cases deal with the enforceability of arbitration clauses. Where there is evidence of a valid electronic signature process, arbitration clauses in electronic notes have been routinely upheld.[607] However, often the person claiming the validity of an electronic contract must provide evidence allowing this determination to be made. This was the situation in one case in which an online lender's motion to compel arbitration was initially denied. The court required the online lender to show that the borrower had agreed to the arbitration provision. The online lender produced a declaration detailing its process for obtaining consent to electronic contracting and provided screenshots showing how borrowers agree online to loan agreements and how the platform tracks such agreements and any exercise by a borrower of its right (which the lender's documents allowed) to opt out of the arbitration clause.[608] The court then allowed arbitration. Lenders must take care in determining how they will provide for the electronic execution of contracts since some courts have ruled against contract formation where a touch screen does not enable the customer to review contract terms (and therefore there is no agreement to those terms)[609] or where terms are hidden, are not called to the customer's attention or are located beneath unrelated prompts.[610]

In another action based on a defaulted loan made by a marketplace lender online, the holder of the note filed a motion to compel arbitration to enforce a promissory note executed online. The note utilized a provision often used in online lending transactions allowing the platform to sign the final form of the note as the borrower's attorney-in-fact. The plaintiffs claimed that they neither signed the promissory note nor authorized the marketplace lender to sign the note on their behalf. They also claimed that the defendants had not demonstrated a proper chain of title so as to be able to enforce the loan. The court concluded that the evidence was not sufficient to rule on the motion and requested additional evidence.[611] Hence, any efforts to compel arbitration will require proof of a valid electronic

607 *See, e.g., Delgado v. Ally Fin., Inc.*, 317CV02189BENJMA, 2018 WL 2128661 (S.D. Cal. May 8, 2018).

608 *Moses v. LendingClub,* 217CV03071JADPAL, 2019 WL 489092 (D. Nev. Feb. 6, 2019), distinguishing *Carlos v. Patenaude & Felix A. P.C.,* 736 Fed. Appx. 656 (9th Cir. June 6, 2018) (failure to produce evidence of electronic agreement as presented to borrower); ECF No. ___, Case No. 2:17-cv-03071 (D. Nev.) (underlying allegations deal with improper access of consumer reports in violation of the Fair Credit Reporting Act).

609 *Nat'l Fed'n of the Blind v. Container Store*, 904 F.3d 70 (1st Cir. 2018).

610 *See, e.g., Starke v. SquareTrade, Inc.*, 2019 WL 149628 (2d Cir. Jan. 10, 2019). *Starke v. SquareTrade, Inc.*, 913 F.3d 279, 281 (2d Cir. 2019).

611 *Vandehey v. Asset Recovery Sols.*, LLC, 18-C-144, 2018 WL 6804806 (E.D. Wis. Dec. 27, 2018) (Prosper marketplace loan).

consent process.[612] In that action, after providing additional information, the court granted the motion to compel arbitration.[613]

Another case saw the issue of electronic contracting intersect with arbitration. A federal magistrate recommended that a class action concerning a data breach be sent to arbitration because users agreed to arbitrate claims against the online lending marketplace. The court agreed and granted a motion to compel arbitration and stay the action.[614] The plaintiff stated that he never saw the user agreement containing the arbitration provision because it was concealed on the platform's website. But the website fully informed users that they were agreeing to abide by the terms of use by creating an account, which information was in a reasonable font and had a noticeable hyperlink. Users also had to agree to the terms in order to submit a loan request. The substantive claims related to a data breach.

Although not related to financial services but related to a fee, a Seventh Circuit case laid out some considerations for electronic contracting.[615] The court explained that while clicking acceptance creates an enforceable contract, that was not present in this case. However, the contract was found to be enforceable despite protestations that there had been failure to disclose a fee connected to making online transactions. The court said that a hyperlink was conspicuous even if the consumer did not open it and that the agreement to proceed with the transaction was sufficient to constitute acceptance. But the point remains that care must be taken to be sure that electronic communications will result in enforceable contracts.

### H. Beware of Electronic Communications

***Providing Adequate Disclosures.*** A recent Seventh Circuit decision should cause lenders and online companies to re-evaluate how they use electronic communications in their day-to-day operations.[616] In a debt collection situation, the plaintiff incurred medical debts and was sent an email by a collector indicating that it had sent the debtor a secure message containing a hyperlink for the debtor to view. The secure message contained the validation notice required by the Fair Debt Collection Practices Act to be given in connection with the first communication to a debtor. The technology systems of the collector showed that the debtor never opened the secure message and hyperlink and therefore never accessed the validation disclosure. Later, the debtor received a phone call about the debt, the first time the debtor had known about the debt collector. The collector admitted that it had not provided the validation notice after the phone call. The plaintiff filed an action alleging failure to deliver the required

612 A loan agreement containing an arbitration clause was upheld in *Ngo v. PMGI Fin., LLC*, 18-CV-05401-JCS, 2018 WL 6618316 (N.D. Cal. Dec. 18, 2018) (recognizing that a checkmark can be an electronic signature and assent is shown where checking a box is required in order to proceed with the transaction).

613 *Vandehey, supra.* Order dated Mar. 24, 2019, also denying motion for class certification.

614 *Granados v. Lending Tree, LLC,* Case No. 3:22-cv-504-MOC (D.N.C. Mar. 1, 2023).

615 *Domer v. Menard, Inc.*, Case No. 23-2672 (7th Cir. Sept. 3, 2024).

616 *Lavallee v. Med-1 Solutions, LLC,* 932 F.3d 1049 (7th Cir. 2019).

disclosure. The collector claimed that the emails satisfied its disclosure obligation as they allowed the debtor to obtain the disclosures. The lower court disagreed, finding that the required notice was never given since the debtor never downloaded it, adding that "embedding a hyperlink from an unknown sender made receipt of the notices unlikely."

The Court of Appeals found that "the emails don't measure up" as they did not themselves contain the enumerated disclosures. The court noted that in order to access the required notice, the plaintiff would have to go through six steps including clicking on the hyperlink in the email, checking a box to sign for the secured message, clicking a link to open the secured message, clicking on the attachments tab, clicking on the attached file and then viewing the file or saving it and then opening it. The court stated that, "at best, the emails provided a digital pathway to access the required information." The court rejected that this was an adequate communication containing the mandated disclosures, concluding instead that it only provided a means to access them. Therefore, the disclosures were not adequate.[617]

Lenders and online companies should take note of this decision. Generally, in order to receive disclosures electronically the consumer must agree to do so under the provisions of the federal E-Sign Act and the federal banking agencies.[618] Care must then be taken to ensure that consumers know or understand that a legal disclosure is being provided to them. As this case demonstrates, it is not enough to send an email with a hyperlink or a request to access a secure message. A pathway to the disclosure is not the same as making the disclosure. In this particular case, technology showed that the intended recipient had not accessed the required disclosure. As the spread of electronic communications in lending increases, so will challenges to the validity of required disclosures in that electronic context. Care must be taken to ensure that electronic disclosures being provided to consumers are adequate.

***Proving Electronic Signatures.*** Another instructive case deals with the validity of electronic signatures.[619] The court found that a company failed to prove the electronic signature of a contract. The plaintiff received an unsolicited phone call concerning the financing of a solar energy project. The plaintiff claimed she did not receive or sign any documents to finance the project. The company claimed that she had electronically signed the financing agreement that was verified by DocuSign and contained a signature block with a printed signature. To prove the signature, the company provided the agreement containing the signature block. The court found this to be inadequate and stated that there was no explanation of the process used to sign and verify the signature. The court indicated that evidence was needed to show who sent the agreement, how it was sent, how the signature was placed on the document and who received it and how it was sent back to the company and how the identification was verified. Unless these conditions were satisfied, the court ruled that the electronic signature was

617 Interestingly, the CFPB filed an amicus brief in the action in favor of the debtor. It submitted that the emails could not be written notice because they failed to satisfy the requirements of the federal E-Sign Act requiring an agreement of the consumer to receive disclosures electronically. The court, having made its own finding, did not need to consider this issue.

618 15 U.S.C. § 7001 *et seq.*

619 *Fabian v. Renovate America, Inc.,* 42 Cal. App. 1062 (Cal. App. 4th App. Dist. 2019).

not authenticated. Lenders and others who conduct business electronically should take note of this case. Even if one has an electronically signed agreement with DocuSign verification markers, this may not prove an authentic signature. In order to rely on an electronic signature, one must be able to show the process of verification and be able to verify that process.

*Recording Telephone Conversations.* A nationwide online lender was sued in a putative class action for recording telephone conversations with consumers without the knowledge or consent of the consumers in violation of California and Massachusetts laws (where the marketplace lender had call centers).[620] The facts are somewhat interesting as stated in the complaint. The plaintiff got into a "contentious" discussion with a representative of the platform and "regrettably said a number of rude things." The representative filed for a protective order against the plaintiff and at a hearing the representative's counsel played the telephone recording, which plaintiff claimed was the first time he knew that his conversation (which including providing sensitive personal and financial information) was being recorded. On July 28, 2020, the court issued an order addressing several motions. A cause of action based on Massachusetts law was dismissed while claims under California law were stayed pending the determination of a case by the California Supreme Court. However, the court denied a motion to strike class action allegations. Recording telephone conversations merits looking at compliance with applicable law.

*Adequate Notice of Terms and Conditions*. Another case worth noting deals with whether one has adequate notice that when clicking an online button it constitutes agreement to terms and conditions, in this instance whether allegations of violation of the Telephone Consumer Protection Act were subject to arbitration or not.[621] The plaintiff sued a national sandwich chain after receiving unsolicited text messages after entering his phone number on the company's website in order to receive a free sandwich. The consumer clicked a button stating "I'm in." After being sued, the sandwich chain claimed that the consumer had agreed to its terms and conditions, which were accessible via a hyperlink in connection with the promotion which contained an arbitration provision. The Second Circuit affirmed the district court's denial of arbitration. The court found that the website did not provide sufficient notice that the consumer was agreeing to any legal terms and conditions, but that they were only agreeing to get a free sandwich. The court found that the terms and conditions were not reasonably clear and conspicuous on the promotional page. This decision serves as notice that in order to bind consumers to legal terms and conditions on a website, it must be clear that the consumer is agreeing to legal terms and has had the opportunity to access those terms and conditions prior to agreeing.

620 *Erceg v. LendingClub Corp.,* Case No. 3:20-cv-01153 (N.D. Cal. filed Feb. 13, 2020).

621 *Arnaud et al. v. Doctor's Assocs. Inc. d/b/a Subway,* Case No. 19-3057-cv (2d Cir. Sept. 10, 2019).

## I. Online Agreements—The Importance of Doing It Right

Not only is obtaining customer consent to conducting business and receiving disclosures necessary to online lending programs, but other legal challenges have been made to electronic communications, including the placement of assent in conjunction with disclosures.

A recent Ninth Circuit case is instructive on the use of an online website and contract formation.[622] The court denied a motion to compel arbitration of a putative class action brought for violations of the Telephone Consumer Protection Act. The decision found that plaintiff borrowers did not assent to binding arbitration when presented with a hyperlinked set of terms that contained an arbitration provision. The defendants claimed that by using the website, the plaintiffs had agreed to arbitration. The court stated that to bind a consumer requires a manifest intent to agree to the contract terms.

The court indicated that "clickwrap" agreements—where a website presents users with specific terms and conditions and requires them to indicate their assent by clicking an "I accept" box—create an enforceable agreement. However, a "browsewrap" agreement that contains a hyperlink to the terms to which assent is ostensibly given by continued use of the site is subject to further inquiry. A website that provides a conspicuous notice of the contract terms and which requires the consumer to take some action to demonstrate assent to those terms can create a contract.

> To be effective contracts there must be online notice and disclosure that continuing on the website will result in agreement to contract terms.

In this situation the court found that the webpages did not provide the degree of notice required, as they did not point the consumer to the fact that the terms contained an arbitration provision. The text disclosing the terms was in tiny gray font rather than the blue font typically associated with hyperlinks and was smaller in size than other parts of the website in close proximity to the hyperlink—according to the court, the text was "barely legible to the naked eye." The court concluded that the user's attention was actually drawn *away* from the disclosure and the terms. The court noted that the failures could have been remedied and a contract created with better formatting, better coloring, and more conspicuous lettering that would call attention to the disclosure and hyperlink to the terms and conditions. Further, the consumer was asked to use a "continue" button rather than an "I agree" button and as a result it could not be shown definitively that the consumer had agreed to be bound by the terms because there was no actual notice that by clicking the continue button they were agreeing to any terms and conditions. The court provided suggested language that would be sufficient: "By clicking the 'Continue' button, you agree to the Terms and Conditions which includes mandatory arbitration."

622 *Berman v. Freedom Fin. Network, LLC.*, Case No. 20-16900 (9th Cir. Apr. 5, 2022), *aff'g.* 400 F. Supp. 3d 964 (N.D. Cal. 2019).

This case decision is both a warning and a guide to participants in the marketplace lending industry to diligently design their websites in a manner that assures that adequate notice of contract terms are provided and appropriate consumer consent is obtained so that a binding contract is formed.

### J. Other Relevant Laws

***Bank Secrecy Act Regulations.*** The federal Bank Secrecy Act[623] and related laws require any bank making a loan, and therefore the Funding Bank in the case of Internet loans and, in some cases, the marketplace lender, to adopt policies and procedures to monitor and enforce the following:

- Establish a customer identification program to verify the true identities of borrowers before an account is opened and provide a notice regarding its use of personal information to confirm a customer's identity;
- Determine whether borrowers are on any list of known or suspected terrorists or terrorist organizations issued by federal agencies such as the Office of Foreign Assets Control (*"OFAC"*) and reject any borrower whose name appears on such list;[624]
- Report suspicious account activity that meets the thresholds for submitting a Suspicious Activity Report (*"SAR"*); and
- Implement an anti-money laundering and information sharing program.

The marketplace lender will need to cooperate with the Funding Bank in the implementation of these policies and procedures and also adopt internal procedures to establish compliance with those regulations to which it is directly subject. Recent enforcement actions with Funding Banks for marketplace programs have focused on deficiencies in BSA/AML compliance and remain subject to examination, scrutiny and sanction.

***Telephone Consumer Protection Act.***[625] The TCPA requires that an entity obtain prior written consent before contacting consumers on their mobile phones via an automatic telephone dialing system and/or using an artificial or prerecorded message. Most marketing messages to any phone are also covered.

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623 12 U.S.C. §§ 1829, 1951—1959; 31 U.S.C. §§ 5311—5314, 5316—5332; 12 U.S.C. § 1786(9); 31 C.F.R. pt. 103; and 12 C.F.R. pt. 326.8 (FDIC Regulation).

624 This topic surfaced in December 2015 when it was reported that one of the shooters in the San Bernardino, California killing of 14 people had obtained a loan from a marketplace lender just weeks prior to the attack. However, the individual had passed both identification checks and an OFAC screening. Thus, any lender would not have been able to make a determination that this individual should not have received a loan.

625 47 U.S.C. § 227 *et seq.* and 47 C.F.R. pt. 64.1200 *et seq.* The Telemarketing and Consumer Fraud and Abuse Prevention Act and the Federal Telemarketing Sales Rule are found at 15 U.S.C. pt. 6101-6108 and 16 C.F.R. pt. 310.

> **Worth Remembering:** It is recommended as a best practice that appropriate TCPA consent be obtained where the consumer's phone number is requested. If consumers are asked to provide phone numbers as part of a loan application, and in particular if mobile numbers are specifically requested, the TCPA disclosure should be provided and consent obtained. Consumers must also have the ability to revoke their consent to be called under the TCPA.

The TCPA poses compliance challenges and has been a hotbed for litigation in recent years. Damages are $500 per call for negligent violations and $1,500 per call for willful violations. As a result, thousands of lawsuits have been filed and many are pending due to the potential windfall from such damages, which are unlimited under the TCPA. Most TCPA actions are filed as class actions.

The Federal Trade Commission also manages the National Do Not Call Registry that prohibits telemarketing sales calls to individuals who have signed up on the registry. In addition, some 40 states have laws restricting telemarketing. The state laws are not uniform. Care should be taken in any telephone marketing situation and where autodialers, prerecorded messages, or calls to cell phones are being made.

Calls to cell phones have prompted large amounts of litigation—much of it in the form of class actions—against marketers, lenders, and servicers. These claims are being made under the Telephone Consumer Protection Act (*"TCPA"*).[626] Plaintiffs' lawyers find TCPA litigation advantageous due to the potential of huge damage awards, which warrant a further discussion of the law and its implications.

*Case in Point—Shifting Interpretations of TCPA and the 2015 Order.* The TCPA was enacted in 1991 to stem the costs and nuisance of unwanted telemarketing by prohibiting calls using an Automated Telephone Dialing System, commonly referred to as an "autodialer," to call certain types of phones without prior consent. As part of the TCPA, prior consent (and in the case of telemarketers, prior *written* consent) is required when a company makes a call using an autodialer or uses a prerecorded message in a call to a cell phone.[627] Prior consent is also required for some landline telemarketing calls when the call uses a prerecorded message.[628]

Much has changed in technology, in business, and in the way that cell phones are billed since the TCPA was enacted that undermines or creates gray areas with respect to the law's definitions and scope. Over the years the Federal Communications Commission (*"FCC"*), the regulator that has rulemaking and enforcement authority for the TCPA, has issued several Rules and Orders that attempt to interpret the law's requirements, particularly with respect to non-telemarketing companies that use autodialers for

626 47 U.S.C. § 227.

627 47 U.S.C. § 227(b)(1)(A)(iii).

628 47 U.S.C. § 227(b)(1)(B); 47 C.F.R. pt. 64.1200.

debt collection purposes.[629] A Declaratory Ruling and Order issued in July 2015 (the *"2015 Order"*)[630] is the most recent of these interpretive efforts. The 2015 Order set forth an expansive interpretation of various TCPA concepts in a manner that is detrimental to those subject to its requirements, including financial companies.

Several entities petitioned courts for review of the 2015 Order. These cases were ultimately consolidated and the U.S. Panel on Multidistrict Litigation randomly selected the U.S. Court of Appeals for the D.C. Circuit to hear the matters.[631] The petitions all argue that the FCC in its 2015 Order exceeded its authority and made it very difficult for companies to comply with the TCPA.[632] In October 2016, the U.S. Court of Appeals for the D.C. Circuit heard oral argument in the consolidated case.[633]

Under the 2015 Order, any system that has the present *or future* capacity to be an autodialer counts as one for the purposes of the TCPA.[634] This is contrary to the definition of "capacity" in the TCPA, which refers only to an instrument's present capacity. In oral argument, counsel for the petitioners argued that devices like smartphones, with the ability to install and use certain applications, could therefore be included under the definition of autodialer. Indeed, it is hard to imagine a device that would not fall under this broad definition besides a rotary phone. The parties disputed what types of devices should qualify as an autodialer in oral argument, with the petitioners arguing for a narrower scope than that provided in the 2015 Order.

In addition, under the 2015 Order, consent to be called, one of the main defenses to TCPA litigation, has become easier to revoke. Some courts had previously held that because the TCPA was silent regarding revocation, it was impossible to revoke consent to be called.[635] Others disagreed and pointed

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629 *See, e.g., In re Rules & Regs. Implementing the TCPA of 1991*, 7 FCC Rcd. 8752, 8769 (Oct. 16, 1992); *In re Rules & Regs. Implementing the TCPA of 1991*, 27 FCC Rcd. 1830, 1838 (Feb. 15, 2012).

630 *See Rules and Regs. Implementing the Telephone Consumer Protection Act of 1991, Declaratory Ruling and Order,* CG Docket No. 02-278, FCC 15-72, at ¶ 49, 52 (July 10, 2015).

631 The first was *ACA Int'l v. FCC*, No. 15-1211 (D.C. Cir. filed July 10, 2015). Next was *Sirius XM Radio, Inc. v. FCC*, No. 15-1218 (D.C. Cir. filed July 14, 2015), and then *Prof'l Ass'n for Customer Engagement, Inc. v. FCC*, No. 15-2489 (7th Cir. filed July 14, 2015). These cases, along with others, were consolidated since filing and the U.S. Panel on Multidistrict Litigation randomly selected the U.S. Court of Appeals for the D.C. Circuit to hear the matters.

632 *ACA Int'l et al. v. Fed. Commc'ns Comm'n*, Case No. 15-1211, at ECF No. 1599016 (D.C. Cir. Feb. 16, 2015). The petition focuses on four issues: (1) the FCC's interpretations of the TCPA are inconsistent, unclear, and ambiguous; (2) the FCC's interpretation of what constitutes an autodialer is overly broad and inconsistent with other language in the statute; (3) the definition of "called party" under the TCPA is ambiguous due to the frequency of "ported" numbers; and (4) the revocation of consent rules is impractical and unjustified.

633 The "one-call safe harbor" introduced by the FCC in its 2015 Order was another issue raised in oral argument. Many phone lines that used to be associated with a residential landline have now been "ported" to ring on a cell phone, and the safe harbor would give a company that is calling what it thinks is a landline one chance to ascertain if the number has changed to a cell phone, since the compliance requirements for cellular phones are much more stringent than those for landlines. The petitioners argued that the safe harbor is not effective and does not help companies comply with the TCPA.

634 *See Rules and Regs. Implementing the Telephone Consumer Protection Act of 1991, Declaratory Ruling and Order*, CG Docket No. 02-278, FCC 15-72, at ¶ 16 (July 10, 2015).

635 *See Gager v. Dell Fin. Servs., LLC*, 727 F.3d 265, 270 (3d Cir. 2013) for discussion of previous court interpretations of consent.

to the Fair Debt Collection Practices Act requirement that requests to cease and desist calling be in writing.[636] The 2015 Order, however, allows consent to be revoked by "any reasonable means."[637] Thus, a very difficult burden is placed on companies who now have to make a decision and create new policies on whether an attempted revocation is "reasonable," and can no longer require that revocation be in writing. Petitioners made this point in oral argument and argued that standardized methods of revocation should be codified.

The D.C. Circuit issued its long-awaited decision in March 2018, setting aside the FCC's expansive definition of an autodialer and rescinding the rules related to calling reassigned mobile numbers but retaining consumers' ability to revoke consent in any reasonable manner.

***Consumer Ability to Revoke TCPA Consent.*** The issue of how a consumer can revoke consent to receive autodialed calls continues to be a hotbed of litigation, with potentially conflicting decisions. In the Second Circuit, dealing with an auto loan, the court held that the consumer borrowers cannot revoke their TCPA consent if that consent was part of the bargained for consideration for the loan, *i.e.,* a part of the loan contract.[638] But in the Eleventh Circuit, the court found that a consumer can revoke TCPA consent on a limited basis such as revoking the consent from 8 a.m. to 5 p.m. on business days.[639] More recently, the Eleventh Circuit held that TCPA consent that is contained in a contract cannot be unilaterally revoked.[640]

***Online Warning—Location of the TCPA Consent Matters.*** At least two recent decisions highlight the importance of the placement of the TCPA consent on a website.[641] One of these cases was brought against a lender by a consumer who had completed an online quote request form on the lender's website. The request form required the consumer to provide personal information including a phone number, followed by a "Get your free quote" click button. Below the click button and outside the box containing the request form, there was additional language stating that the consumer consented to receive telephone calls and text messages from the lender. The consumer started receiving phone calls and filed a class action suit alleging a TCPA violation. The lender moved to dismiss the case, claiming that written consent had been provided by the consumer. The court thought otherwise. The court held that the small font used for the TCPA disclosure and its placement below the click button made it unlikely that the consumer knew that by clicking the button, they were agreeing to receive autodialed

636 *Id.*

637 *See Rules and Regs. Implementing the Telephone Consumer Protection Act of 1991, Declaratory Ruling and Order*, CG Docket No. 02-278, FCC 15-72, at ¶ 54\5 (July 10, 2015).

638 *Reyes v. Lincoln Auto/ Fin. Serv.,* 2017 WL 2675363 (June 22, 2017).

639 *Schweitzer v. Comenity Bank,* 866 F.3d 1273 (11th Cir. Aug. 10, 2017).

640 *Medley v. Dish Network LLC,* Case No. 18-13841 (11th Cir. 2020).

641 *Barrera v. Guaranteed Rate, Inc.,* 2017 WL 4837597 (Oct. 23, 2017); *Sullivan v. All WebLead, Inc.* 2017 WL 2378079 (June 1, 2017).

calls from the lender. The second case also involved a TCPA consent disclosure that appeared below a submit button and in smaller print.

> **Compliance Tip:** For marketplace lending participants using websites or giving online disclosures, the clear message from these cases is that TCPA consent language must be placed in a logical location with conspicuous print and call attention to the significance of the language so as to put consumers on notice that they are giving their consent by clicking an "I agree" or similar button. This advice should equally apply to any form of disclosure and online agreement.

***TCPA Violations Alleged Against Business Lender.*** A business filed a class action lawsuit in federal court in Illinois against an online business lender and its Funding Bank for violations of the TCPA and the Illinois Consumer Fraud Act.[642] The complaint alleges that the plaintiff class members received unsolicited faxes marketing loan products and services from the defendants resulting in a "loss of paper, toner, ink, use of facsimile machines and employee time." Most recently, the court granted a motion to strike the class claims, but gave the plaintiff the chance to amend the complaint to correct deficiencies.[643] Even business lenders are not immune from suit based on consumer types of claims and must defend such actions.

In 2022, the Ninth Circuit vacated a jury verdict of $925 million in statutory damages for over 1.8 million prerecorded calls without prior consent under the TCPA as violating the defendants' constitutional due process rights.[644] The court stated that due process is violated where statutory damages are so severe and oppressive to be wholly disproportionate to the offense and therefore unreasonable. Thus, while the per-violation amount was constitutional, it resulted in excessive damages. This decision has implications for class actions where statutes like the TCPA that permit large aggregate awards create unreasonable verdicts.

***ADA and Website Accessibility for the Disabled.*** In 2010, the Department of Justice indicated that it would propose rules under the Americans with Disabilities Act (*"ADA"*) with respect to making websites accessible to individuals with disabilities. However, in 2017 the agency indicated that rulemaking on this subject was on its "inactive" regulatory agenda. It is not known if or when any regulations will be promulgated. However, in the interim, a wave of litigation has ensued, primarily against online retailers alleging that their websites fail to accommodate the visually impaired and seek to have software technology imposed that would allow access by the disabled. In June 2017, in the first case to go to trial on the issue, a federal judge ruled that the lack of accessibility of a supermarket chain's website

642 *A Custom Heating & Air Conditioning, Inc. v. Kabbage, Inc., Celtic Bank et al.*, No. 16-CV-2513 (N.D. Ill. filed Feb. 3, 2016).

643 2018 U.S. Dist. LEXIS 8975 (N.D. Ill. Jan. 1, 2018).

644 *Wakefield v. ViSalus, Inc.*, 51 F.4th 1109 (9th Cir. 2022).

violated a blind man's rights under the ADA.[645] Although we are not aware of any cases pending on this issue against marketplace lenders, without a clear regulatory standard, there is a risk of federal litigation if a website cannot accommodate consumers with disabilities.[646]

***CAN-SPAM.***[647] The CAN-SPAM Act establishes requirements for anyone who sends commercial or transactional messages by email and gives recipients of commercial emails the right to ask to be placed on an opt-out list. A commercial email is one whose primary purpose is promoting or advertising a commercial product or service, while a transactional email is one that facilitates an agreed-upon transaction or updates a customer in an existing business relationship. A commercial email is subject to more restrictions than a transactional one, for example, restrictions on sender information and subject line, identification as an advertisement, and provision of an opt-out method. However, a transactional email cannot contain false or misleading routing information. The CAN-SPAM Act applies to emails sent to both consumers and business entities.

The law provides penalties for noncompliance for both the company that sends the email and the company whose products are advertised in a commercial email. The sender is subject to a penalty of up to $16,000 for each unlawful email. Due to the potential for damages, care should be exercised if email messages are utilized as part of a marketplace lending program.

***Federal Arbitration Act.*** Many loan agreements in the online lending space contain an arbitration provision. Arbitration is subject to the Federal Arbitration Act.[648] This law facilitates the resolution of private disputes through the use of an arbitrator. The U.S. Supreme Court has shown a preference for arbitration in its decision for example upholding class action waivers in arbitration clauses.[649] The law generally preempts state law except in instances of unconscionability or violation of public policy.[650]

Recent cases have shown that lenders can use these provisions to redirect court proceedings into an arbitration forum where the case is ultimately settled or dismissed. Such was the situation with a recent class action filed in March 2018 in state court by a retailer against a small business lender and its

645 *Gil v. Winn-Dixie Stores Inc.,* 242 F. Supp. 3d 1315 (S.D. Fla. June 13, 2017). The case is on appeal to the 11th Circuit Court of Appeals (Case No. 17-13467).

646 Financial institutions, particularly credit unions have been the focus of ADA claims in litigation. Those cases have largely been thwarted because the disabled person could not become a member of the credit union in any event. Three circuits have dismissed such suits. *See, e.g., Carello v. Aurora Policeman's Credit Union,* 930 F.3d 830 (7th Cir. 2019).

647 The Controlling Assault of Non-Solicited Pornography and Marketing Act of 2003, 15 U.S.C. § 7701 *et seq.*

648 9 U.S.C. § 1 *et seq*.

649 *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228 (2013).

650 California cases have ruled that federal law is not preempted where the arbitration clause prohibits the bringing of a public injunction. *McGill v. Citibank, N.A.,* 393 P.3d 85 (Cal. 2017). This came after the U.S. Supreme Court found that a California law making class action waivers unconscionable should not be followed and consumers were bound by contractual provisions containing class action waiver clauses. *AT&T Mobility v. Concepcion,* 563 U.S. 333 (2011). As a result, arbitration remains uncertain in California actions although some cases allow arbitration to proceed.

Funding Bank.[651] The defendants removed the case to federal court. The complaint challenged the platform's program with a Utah bank and alleged that it purposefully evades criminal usury laws. The suit asserted violations of California usury laws and consumer protection laws against false advertising and unfair competition and also alleged violations of federal racketeering (*"RICO"*) laws. The defendants' motion to stay the action pending the outcome of arbitration was granted. The case was dismissed in December 2018. The presence of the arbitration agreement not only sent the case to arbitration rather than court, and avoided a class action proceeding, but also resulted in a stipulation of dismissal being filed, thereby ending the case.

Arbitration clauses remain helpful in settling lawsuits and avoiding class actions.

***Military Lending Act.*** An issue facing the auto lending industry was whether a loan to purchase a car that also financed ancillary or add-on products and services such as guaranteed asset protection (GAP) insurance was subject to the Military Lending Act (*"MLA"*) or not. Actions under the MLA are attractive to plaintiff lawyers because the penalty for a violation is voiding of the loan. Regulatory agencies including the CFPB also target MLA violations on an ongoing basis. The MLA exempts loans with the express purpose to purchase the property that will serve as collateral for the loan (like an automobile), but there has not been clarity about the situations where add-on products and services are part of the loan. In April 2023, the Fourth Circuit Court of Appeals weighed in on the issue.[652] The court found that add-on products could be financed without losing the exemption from MLA compliance. The court reasoned that the statute's language speaks of the exemption in terms of where the express purpose of the loan—not the sole purpose of the loan—is to purchase the property being financed and acting as collateral security.

### K. Small Business Lending—Section 1071 of Dodd-Frank

Almost 15 years ago, in 2010, Congress enacted the Dodd-Frank Act,[653] which in part amended the Equal Credit Opportunity Act to require lenders to collect and report application data for women-owned, minority-owned and small businesses. This requirement was found in Section 1071 of the law. Rulemaking languished such that the CFPB was sued over its failure to issue regulations and ultimately agreed to a timeframe in which to issue those regulations.[654] Finally, on March 30, 2023, the CFPB

651 *Barnabas Clothing, Inc. et al. v. Kabbage, Inc. and Celtic Bank Corp.*, No. 2:18-cv-03414-PSG-SS (C.D. Cal.).

652 *Davidson v. United Auto Credit Corp.*, Case No. 21-1697 (4th Cir. Apr. 12, 2023).

653 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, July 21, 2010.

654 *California Reinvestment Coalition et al. v. Kraninger and Consumer Fin. Prot. Bureau*, Case No. 4:19-cv-02572-JSW (N.D. Cal. filed May 14, 2019).

issued its final rule implanting Dodd-Frank Section 1071. While affecting all lenders, this final rule will have data-collection and reporting implications for online commercial lending platforms.[655]

The regulation will apply to lenders pertaining to at least 100 covered originations in each of the two preceding calendar years. The rule requires lenders to collect and report data about applications from a small business. A small business is one that has $5 million or less in gross annual revenues in its preceding fiscal year. Coverage includes loans, lines of credit, credit cards, merchant cash advances and credit products used for agricultural purposes.

Business lenders face new data-collection requirements that will impact operations.

The operational impact of the regulation is that the lender is required to collect and report several data points derived from the credit application. Credit denials require reporting of denial reasons. The information must be collected on a calendar-year basis and reported to the CFPB before June 1 of the following year.

Certain trade groups including the American Bankers Association filed suit against the CFPB, challenging the enactment of the regulations, including exceeding its authority and also on the basis that the CFPB was unconstitutional.[656] In October 2023, a nationwide injunction was issued halting implementation of the regulation pending the Supreme Court's resolution of the status of the constitutionality of the CFPB. After that decision, the case proceeded and on August 26, 2024, the court ruled that the CFPB did not exceed its authority when issuing the regulation.[657] That decision is being appealed to the Fifth Circuit Court of Appeals. In the interim, the CFPB has issued new compliance dates for the rule. The Fifth Circuit has stayed compliance while the appeal is pending.

The regulation imposes on larger lenders a requirement to report data earlier than smaller lenders. A lender must collect data as of July 1, 2026, if it originated 2,500 or more transactions and report by June 1, 2027. Moderate volume institutions must begin collecting by January 1, 2027, and report by June 1, 2028. Other lenders must comply on or before October 1, 2027, and report by June 1, 2028. This regulation should only affect commercial and business marketplace lending programs. However, changes to the application process, data collected and the systems needed to collect and report the data will likely be significant to business marketplace lenders.

655 A comprehensive discussion of these regulations is beyond the scope of this paper, but we have outlined some of the major provisions of particular interest to online commercial lenders.

656 *Texas Bankers Ass'n et al. v. Consumer Fin. Prot. Bureau et al.*, Civil Act. No. 7:23-CV-00144 (S.D. Tex. 2023).

657 Some of the plaintiffs had filed motions to add claims that the CFPB remained illegal because its funding must come from the combined earnings of the Federal Reserve, which have been negative. However, those plaintiffs withdrew their motions so the matter could be appealed.

## IX. STATE DEVELOPMENTS

***NYDFS Cybersecurity Rule.*** On February 16, 2017, the New York Department of Financial Services (*"NYDFS"*) announced that its final cybersecurity rule for financial institutions would take effect beginning on March 1, 2017. The NYDFS had issued a revised version of the proposed rule on December 28, 2016, after receiving more than 150 comments in response to its initial proposed rule.[658] The NYDFS cybersecurity rule imposes broad requirements that are more stringent than the federal requirements under the Gramm-Leach-Bliley Act Safeguards Rule. It requires banks, insurance companies, and other financial services institutions regulated by the NYDFS to establish and maintain a cybersecurity program designed to protect consumers and ensure the safety and soundness of the New York financial services industry.

Specifically, the NYDFS cybersecurity rule requires covered entities to encrypt certain nonpublic data both in transit and at rest; limit the retention and ensure the timely destruction of nonpublic information, essentially mandating a record retention policy; conduct vulnerability assessments at least quarterly; and conduct penetration testing and written risk assessments of their information system at least annually, among other requirements. Although the 2016 revisions to the rule included longer timeframes for compliance and more flexibility for covered entities in satisfying its requirements than the original proposed rule, the NYDFS cybersecurity rule remains substantially different from the federal regulatory approach, and may pose challenges and require significant time and resources for covered entities to comply.

After a two-year transitional period and separate compliance dates for different portions of the NYDFS cybersecurity rule, full compliance was required for all covered entities by March 1, 2019.

***California Enforcement Action.*** A 2016 California Department of Business Oversight (the *"DBO"*) action decision appears to expand entities that need to be licensed under the California Financing Law.[659] The decision upheld a cease-and-desist order against an entity that did not fund loans to borrowers but solicited borrowers, evaluated the credit, proposed loan terms, and made or participated in credit advances. The DBO rejected the argument that a license was needed only if the entity actually made loans, instead concluding that lending-related activities may also require licensing. It remains to be seen if this could be the DBO's way of reaching marketplace lenders to require licensing. As referenced elsewhere in this book, California has also targeted data aggregators and "buy now pay later" companies for licensing under California law.

***State Legislation.*** Some states are contemplating additional licensing for marketplace lenders. For example, in New York, Governor Cuomo's proposed budget for fiscal year 2018 contained a change to

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658 NYDFS Press Release, Feb. 16, 2017, available at https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1702161; Proposed 23 NYCRR 500.

659 *In the Matter of the Desist and Refrain Order Against Fin. Servs. Enter. dba Pioneer Capital*, OAH No. 2016040551 (Nov. 29, 2016). The DBO is now the Department of Financial Protection and Innovation.

existing law regarding financial services licenses.[660] While current law requires a license to make loans above 16% to consumers (up to $25,000) and to businesses (up to $50,000), the proposal, if enacted, would require licensing for anyone making loans at any rate and would ensnare many marketplace lending participants, as it would include entities soliciting and purchasing or acquiring consumer and business loans and those who arrange or facilitate the funding of loans.[661] Legislation is also pending in New York that would create a licensing requirement for commercial lenders.[662]

In mid-2016, a bill was introduced in the Illinois legislature that would impose licensing for online commercial lenders and for loan purchasers, regulate commercial lending practices, and require significant loan disclosures and ability to repay assessments. While the legislation was never considered in 2016, it could be re-introduced in the future and shows an interest in regulating small business lending in addition to consumer loans.

***State Regulators Promote Innovation.*** In January 2018, the Conference of State Bank Supervisors (*"CSBS"*) promulgated Vision 2020, an effort to modernize state regulation of non-bank companies, including fintech companies. The goal of this project is to provide an integrated 50-state licensing and supervisory structure by leveraging technology and cooperation among the states, which indicates the CSBS's support for innovation on a national scale.[663] In one of its first actions toward this end, the CSBS appointed an advisory panel consisting of industry participants to advise the state regulators on how to better supervise non-bank fintech companies. Further to these efforts, on February 6, 2018, seven states entered into a compact to coordinate the licensing of money services businesses.[664] This pilot program is the first step toward the integrated multistate approach to licensing and supervision.

Meanwhile, on March 22, 2018, Arizona became the first state to pass legislation allowing financial companies to experiment with innovative products and services directly with consumers in a true regulatory sandbox, which will be administered by the Arizona Attorney General's office. This will allow financial companies to bypass state licensing requirements and offer their products and services to up to 10,000 consumers for a period of two years. The expressed goal of the program is to attract innovators to the state, although the legislation was met with opposition from consumer groups. Modeled after similar experiences in the United Kingdom, Arizona now holds the distinction for being the first state in the United States to legitimize the regulatory sandbox concept. Since then, nine other states have enacted legislation promoting regulatory sandboxes, including Florida, Hawaii, Kentucky, Nevada, Utah, Vermont, West Virginia, and Wyoming.

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660 N.Y. BANKING LAW § 340.

661 The legislation potentially covers merchant cash advances and factoring. Other states are considering such legislation. See the "Recent Developments in Marketplace Lending Regulation" section.

662 S. 1061B.

663 However, as described above, the CSBS has brought litigation against the OCC to prevent it from moving forward with issuing a national bank charter for fintech companies.

664 The states are Georgia, Illinois, Kansas, Massachusetts, Tennessee, Texas, and Washington.

## A. Enforcement Actions

### *1. Massachusetts—$1.25 Million Penalty from Online Lender*

In January 2020, the Massachusetts Attorney General settled allegations against an online lender for $1.25 million.[665] The claim related to the amount of interest charged on small loans. The Commonwealth claimed that the online lender charged excessive interest greater than that allowed by the usury limit on small loans. The fact situation is somewhat unique in that a small loan as defined by Massachusetts law is a loan of $6,000 or less. However, the way the statute is written, the $6,000 is the amount disbursed to the customer, not the face amount of the loan. As a result, it was alleged that while the platform made loans for more than $6,000, the amount disbursed to the borrower was $6,000 or less (due to upfront origination fees) and therefore fell within the ambit of the Small Loan Law which has a maximum interest rate. The platform also agreed to stop making small loans in Massachusetts with interest rates above the allowable rate cap.

### *2. Pennsylvania Licensing of Master Servicer Even When Subservicer Is Licensed/Debt Collector*

An online lender was licensed in Pennsylvania as a mortgage lender and as a lender under the Commonwealth's small loan law but was not licensed as a mortgage servicer. The platform believed it was allowed to service loans it originated using a licensed subservicer, although it held the master servicing rights for the loans. However, the applicable Pennsylvania law requires licensing for anyone "directly or indirectly" servicing a mortgage loan.[666] Thus, even a master servicer though not engaging in direct servicing activities was required to be licensed, and failure to have a license was a violation of the statute. In this case, the platform paid a fine of $110,000 to the Commonwealth.[667] Platforms that have servicing rights but contract servicing to others need to be cognizant of applicable licensing requirements. As this action illustrates, while those engaging in direct collection may be required to be licensed, even those not engaged in direct servicing activities but are master servicers or hold servicing rights may need to have a license in some jurisdictions.

Another interesting licensing case was filed in Pennsylvania. In a putative class action, the plaintiff sued a debt collector collecting loans originally made by WebBank but subsequently charged off, alleging that the collector could not collect more than 6% interest, the Pennsylvania usury rate, unless it held a Consumer Discount Company license.[668] The complaint also alleged that collecting interest at greater than the state limit also violated the federal Fair Debt Collection Practices Act. The complaint cited the

665 *In re LendingClub Corp.,* Civ. Act. No. 20-0155C (Sup. Ct. Suffolk Cty.). Assurance of Discontinuance filed Jan. 17, 2020.

666 7 PA. CONS. STAT. § 6102.

667 *Commonwealth of Pennsylvania Dep't of Banking and Sec. Compliance Office v. SoFi Lending Corp.,* Docket No. 19-0079 (BKG-CAO). Commonwealth of Pennsylvania Dep't of Banking and Securities. Consent Agreement and Order of Sept. 12, 2019.

668 *Meola et al. v. Velocity Invs., LLC,* Case No: 2:19-cv-00997-DSC (W.D. Pa. filed Aug. 13, 2019).

statute that required a license to "charge, collect, contract for or receive interest" in excess of 6% a year as the basis of its claim. The case was settled and dismissed on undisclosed terms on January 15, 2020. But the complaint reinforces the precept that all aspects of online lending can be subject to state licensing and platforms should ensure that they have any applicable licenses to engage in marketing, lending, servicing, collection or purchasing activities.

#### *3. California—Investigation of Auto Lending Relationship*

On January 1, 2020, California law changed. Under legislation known as Assembly Bill 539, interest rates were capped on installment loans between $2,500 and $10,000 were capped at 36% plus the Federal Funds rate. Prior to that time, those loans would not be subject to any rate ceiling if the lender held a California loan license, subject only to the potential theory of unconscionability of the loan.[669] Some lenders indicated that they would attempt to skirt the law by entering into arrangements with federally insured depository institutions. That approach was criticized by lenders and consumer advocates. One licensee that previously made loans under its California Financing Law license entered into a program with a bank in Utah, which under principles of federal preemption could make loans in excess of the California usury limits. In September 2020, the California Department of Business Oversight, which regulates loan licensees, announced that it was investigating an auto loan licensee that had entered into a relationship with the bank to make loans to California residents by the bank rather than under the California loan license.[670] The state indicated it wanted to determine if the licensee's role in the bank program was so extensive as to require compliance with California laws. This would suggest implication of true lender claims. The California regulator entered into a consent order with the Company in December 2021.

#### *4. Massachusetts*

In May 2024, the Massachusetts Attorney General entered into an "Assurance of Discontinuance" with respect to an online lending program.[671] Although loans were being made by a Utah chartered bank, the bank was not a party to the action. Rather, the finance company was the target of the regulator for loans that had annual percentage rates in excess of 100%. The online company paid $625,000 in restitution to borrowers, was forced to stop collecting on loans and agreed to stop doing business in

669 *De La Torre v. CashCall, Inc.*, S 241434 (Cal. Sup. Ct. Aug. 13, 2018), question from the Ninth Circuit Court of Appeals Case No. 14-17571 (a loan could be found to be unconscionable even if the statute had no interest rate ceiling). A.B. 539 also provided that a California Financing Law loan cannot be found to be unconscionable based on the interest rate alone. This may not be necessary since the court decision indicated that all of the facts and circumstances surrounding the loan must be considered before declaring the rate as unconscionable. Properly read, the decision itself would not allow the interest rate charged on the loan in and of itself to determine unconscionability.

670 The licensee involved was Wheels Financial Group dba LoanMart. It is somewhat unusual for a regulator to announce that it was issuing a subpoena and starting an investigation as opposed to announcing a formal lawsuit or proceeding.

671 *In re Duvera Billing Servs., LLC d/b/a Easy Pay Fin.,* (Sup. Ct. Suffolk Cty. May 21, 2024).

the state. The attorney general claimed that this was a "rent-a-bank" scheme intended to evade state usury limits. The company denied the allegations but agreed to the settlement.

## X. New Products

### A. Buy Now Pay Later

Buy now pay later (*"BNPL"*) programs have proliferated since the last publication, reaching almost $100 billion in 2021. In its December 16, 2021, press release announcing an inquiry directed at five companies,[672] the CFPB described BNPL as follows:

> Buy now, pay later credit is a type of deferred payment option that generally allows the consumer to split a purchase into smaller installments, typically four or less, often with a down payment of 25 percent due at checkout. The application process is quick, involving relatively little information from the consumer, and the product often comes with no interest. Lenders have touted BNPL as a safer alternative to credit card debt, along with its ability to serve consumers with scant or subprime credit histories.
>
> Merchants are adopting BNPL programs and are willing to typically pay 3 percent to 6 percent of the purchase price to the companies, similar to credit card interchange fees, because consumers often buy more and spend more with BNPL. Indeed, BNPL's use has spiked during the COVID-19 pandemic and throughout the holiday shopping season. More and more Americans are using it, and the most recent Black Friday and Cyber Monday shopping weekend saw massive growth in BNPL. This explosive growth has caught the eye of many investors, including significant venture capital money. Big tech companies are also entering the arena.

The CFPB inquiry collected information on the risks and benefits of BNPL. The bureau expressed concerns as to the ease with which consumers can accumulate debt, regulatory arbitrage due to a lack of consumer protections such as disclosures, and data harvesting.[673] In January 2022, the CFPB invited any interested person to submit comments regarding BNPL products. In March 2022, the Attorneys General of 21 states submitted a comment letter expressing concern about the product, while others

672 The five companies to which the CFPB sent inquiries were Affirm, Afterpay, Klarna, PayPal, and Zip.

673 For example, because BNPL products do not charge interest and are paid in four or fewer installments, the federal Truth in Lending Act does not apply. Its protections only apply when interest is charged or a transaction is payable in more than four installments. A BNPL product not meeting this requirement would not have to provide disclosures or be subject to other protections under the rule.

requested that the CFPB provide more consumer protections and disclosures with respect to BNPL products.[674]

> Buy Now Pay Later and other new products are facing regulatory scrutiny, which brought about CFPB action and may result in future regulation.

In September 2022, the CFPB issued a report on BNPL. The report discussed some of the harm and risk that arise from BNPL products. One concern is overextension—that consumers are spending more than they otherwise would and perhaps are not able to afford. This can happen through sustained usage as consumers put more payments on BNPL and thereby impede their ability to repay non-BNPL obligations. The other overextension risk is "loan stacking"—that consumers take out concurrent BNPL loans with different lenders and become unable to pay some or all of them. This situation is exacerbated by the ability to make multiple transactions in a short period of time and by lenders not furnishing performance data to consumer reporting agencies. The bureau also stated that the BNPL companies collect consumer data, which they termed "data harvesting," that could result in risk or harm to consumers in the areas of privacy and security. The agency also theorized that there could be market power with data concentration and that data could be used to benefit some consumers and not others, resulting in consumers paying different prices for the same product with the same seller.

The CFPB Report also cited the lack of adequate disclosure being made to BNPL customers. Usually an up-front disclosure is not made nor are there periodic statements given to consumers because most BNPL transactions are structured so that the disclosure requirements of the federal Truth in Lending Act do not apply. The bureau raises a concern that this lack of disclosure may result in consumers not understanding the product terms, fees and payment requirements. The CFPB also noted that there is no uniform complaint resolution process for BNPL products or for billing error resolution as exists with other credit products. The report also noted that most BNPL programs require the use of "autopay" and make it difficult or impossible to change that feature, which could be a violation of Regulation E that prohibits loan payments to be made by electronic transfer as a condition of receiving the loan. There is also a tacit criticism of BNPL companies making several re-presentments of failed payments and charging multiple late fees on a missed payment.

At about the same time, the Federal Trade Commission (*"FTC"*) reminded non-bank BNPL companies that they can be liable for violations of Section 5 of the FTC Act based on misrepresentations or omissions made about BNPL products. The FTC cautioned market participants not to misrepresent the costs of a BNPL product or its terms. Advertising claims may be deceptive if not true for the typical borrower and must be supported by reliable evidence. The agency also warned against in effect hiding the ball from consumers with having to go through a number of screens, using small icons or "hiding"

674 Several consumer advocacy groups urged the CFPB to treat BNPL products just like credit cards covered by Truth in Lending. Even some creditor trade groups urged more robust information be provided to consumers.

information in long terms of service documents. The FTC stated that both retailers and BNPL players may be held liable for unfair or deceptive practices.

CFPB studies show both risk and benefit from BNPL.

In March 2023, the CFPB issued a new report based on its survey of consumers.[675] Somewhat of a surprise to the CFPB, BNPL is used by people who have other available means or access to credit, including those more expensive than BNPL and, as a result, BNPL can be beneficial as it is a lower-cost option. The CFPB also noted the many BNPL customers use the product without evidence of financial distress but that the average BNPL borrower was more likely to have high amounts of debt, to revolve on credit cards and to have suffered one or more delinquencies on a traditional loan or credit card. The survey also found that BNPL customers had less liquidity and not as much in savings as did non-BNPL borrowers. The CFPB results showed that BNPL users had lower credit scores than non-users. If those customers would normally have higher-rate traditional loan products, BNPL would be advantageous to them. While the CFPB concluded that BNPL borrowers have higher levels of financial distress, the bureau also indicates that these levels could have existed prior to the advent of BNPL products. The CFPB could not conclude whether BNPL moves consumers away from higher interest products or leads them to increase borrowing and cites the need for further research.

Although the earlier CFPB study implied that interpretive guidance or rules under its UDAAP authority would likely occur as to BNPL products, the later report recognizing the beneficial aspects of BNPL and the need for further study may indicate that this will not occur soon. It is not known when the CFPB will provide further guidance or regulation of BNPL products, but some action is expected.[676]

675 The Report was titled "Consumer Use of Buy Now, Pay Later: Insights from the CFPB Making Ends Meet Survey." The survey encompassed over 2,000 consumers.

676 It should also be noted that BNPL providers are also becoming subject to class action litigation primarily on the basis of undisclosed fees (late fees and NSF bank fees) or misrepresentation of the service as being free or containing no hidden fees. In many of these actions, the defendants have filed a motion to compel arbitration due to arbitration provisions in the terms of service or BNPL agreement, which have resulted in dismissals. *See Edmundson v. Klarna, Inc.*, Case No. 3:21-cv-00758 (D. Conn. filed June 2, 2021) (motion to compel arbitration denied and on appeal; action stayed pending appeal), and *Hale v. Klarna, Inc.,* Case No. 3:22-cv-00598-DMS-AHG (S.D. Cal. filed Apr. 28, 2022) (asserting violations of California's unfair competition and false advertising law) (motion to compel arbitration pending). Another BNPL company, Sezzle. was hit with a proposed class action based on similar theories that it deceived consumers by not disclosing the risk of incurring bank overdraft fees. *Sliwa v. Sezzle, Inc.,* Case No. 2:22-cv-03055 (C.D. Cal. filed May 6, 2022) (Stipulation to Dismiss filed). Sezzle previously paid penalties to California for operating without a finance lender's license. *See also Amanda Edwards v. AfterPay US, Inc.*, Case No. 2:22-cv-00118-JDL (D. Maine) (Dismissal filed), and *Miller v. AfterPay US*, Case No. 3:21-cv-04032 (N.D. Cal. filed May 27, 2021) (Dismissal filed).

In July 2022, a public company announced that its BNPL product was being investigated by the CFPB.[677] In 2024, the CFPB issued a regulation on BNPL products which is discussed in the "Recent Developments in Marketplace Lending Regulation" section and which is being challenged in court.

There has been tremendous growth in BNPL products in part as an outgrowth of the COVID-19 pandemic. Typical BNPL products allow consumers to buy a product interest free and pay it off in four installments, the first usually at the time of purchase. The product is attractive because it avoids the definition of credit under the federal Truth in Lending Act.[678] The CFPB began its scrutiny of the BNPL industry in December 2021 by requesting information from five providers. The agency also requested public comment on BNPL in early 2022 and looked at credit reporting on that product in June 2022. In September 2022 the bureau issued a market report of its findings, including perceived risk such as the lack of disclosure and loan stacking where multiple BNPL loans from different lenders are obtained, which may result in late fees or non-payment. In March 2023, the CFPB issued another market report based on its data-gathering efforts, finding that BNPL users were generally financially challenged and that BNPL products were used disproportionately by minority groups and women.[679]

On May 22, 2024, the CFPB issued its long-awaited interpretive rule on BNPL.[680] The CFPB determined that digital user accounts that access BNPL products are considered to be "credit cards" under Regulation Z and that providers of such credit are "card issuers" under Regulation Z, thereby making them creditors with respect to dispute and refund rights.[681] In addition, periodic statements are required on BNPL accounts for each billing cycle, similar to credit cards.[682] On September 18, 2024, the CFPB issued FAQs to clarify its position on compliance with Regulation Z. In particular, the CFPB will require BNPL lenders to investigate disputes that consumers initiate and suspend payment requirements during the investigation pending resolution, which may include credits. The CFPB will also require lenders to credit refunds to customer accounts when they return goods or cancel services. This rule, as well as continued surveillance of the BNPL industry by the CFPB, may lead to operational

677 Apple Pay Later, the BNPL product of Apple, made the announcement. The CFPB stated that the product raised several issues including antitrust and data privacy concerns. It appears that some if not most of this inquiry centers on use of customer data such as browsing history, geolocation history and health data.

678 Truth in Lending applies to transactions where interest is either charged or repayable in more than four installments. Thus, an interest-free pay-in-four product is exempt from the definition of credit under the law and Regulation Z.

679 In December 2023, the OCC issued a bulletin to its supervised banks concerning management of risks in BNPL lending products. OCC Bulletin No. 2023-37: Retail Lending: Risk Management of "Buy Now, Pay Later" Lending (Dec. 6, 2023). This guidance is not as specific or detailed as the CFPB interpretive rule.

680 Interpretive Rule; Request for Comment, Truth in Lending (Regulation Z): Use of Digital User Accounts to Access Buy Now, Pay Later Loans, 89 Fed. Reg. 47068 (May 31, 2024).

681 The agency interpreted the definition of "credit card" under the Regulation that includes an "other credit device" to be broad enough to encompass digital user accounts used through websites or mobile apps in order to access credit.

682 We note that a resolution was introduced in Congress to disapprove of the rule, but it did not advance.

changes and additional regulation.[683] The CFPB has stated it will not reissue the rule, which is defective in that it applies open-end credit rules to a closed-end product.

> New and innovative products like earned wage access and income sharing agreements are attracting regulatory attention.

### B. Earned Wage Access Products

Also becoming popular are Earned Wage Access (*"EWA"*) products. In essence, these products allow an employee to access wages that have been earned, but prior to the time they are paid by the employer. From a legal standpoint, there has been much confusion about EWAs, as they are structured in different ways. Adding to the confusion is a regulatory interpretation made at the latter stages of the Trump era which is being reconsidered by the current administration.

On November 30, 2020, the Trump-led CFPB issued an advisory opinion that certain EWA products did not constitute credit for purposes of the federal Truth in Lending Act.[684] Then, on December 30, 2020, the same CFPB issued a compliance assistance sandbox approval to Payactiv, Inc., regarding its EWA product.[685] Payactiv sought confirmation that its EWA product was not an extension of credit based on how its program operated through employers. The program provided access to wages earned but unpaid and recovered the funds via payroll deduction through the employer. No interest or fees are charged and other attributes associated with credit products are not involved, such as debt collection or credit reporting. The CFPB agreed, finding that the program was not based on creditworthiness and relied on employer information and involvement, including employer-facilitated deductions and the lack of fees or interest, along with the fact that there is no right to collect against the employee.[686] The Biden-led CFPB rescinded this opinion and issued a rule in May 2024 subjecting BNPL to TILA rules. The current CFPB will not enforce the rule as it applies open-end credit provisions to a closed-end product, but will not issue a new rule.

It should be noted that many EWA programs operate differently than the program described in the CFPB approval letter. The approval letter states that it only applies to the recipient's program, so another

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683 States are also involved with regulating BNPL providers. In January 2024, California entered into a Consent Order with Credova Financial and fined it $50,000 for failure to disclose fees that may be imposed when its BNPL account is handled by a third-party servicer. While consumers were told of various payment methods, some of them would incur fees, which was not adequately disclosed per the state.

684 *See* https://files.consumerfinance.gov/f/documents/cfpb_advisory-opinion_policy_2020-11.pdf/.

685 This was the first CFPB opinion issued under that policy (*see* 84 Fed. Reg. 48246), which was to provide more regulatory certainty for new and innovative consumer products. Approvals assure compliance with specified laws, are good for two years, and are subject to extensions.

686 The CFPB relied on a comment to 12 C.F.R. pt. 1026.2(a)(14) which states that borrowing against the accrued cash value of a pension account without an obligation to repay is not credit under Regulation Z. Important to this determination is the employee having no obligation to repay if the payroll deduction is insufficient.

program with different features may not receive the same treatment or have assurance that the program does not constitute credit. However, on June 30, 2020, the Biden-led CFPB terminated the Payactiv approval order, claiming that it had been requested by Payactiv, who was changing its business model. See the "Recent Developments in Marketplace Lending Regulation" section for more updates.

In March 2023, the Government Accountability Office (*"GAO"*) issued a report relating to fintech products including EWA.[687] The GAO recommended that the CFPB should clarify the applicability of the Truth in Lending Act's definition of credit for EWA products not covered in the November 2020 CFPB issuance, recognizing that it is unclear how direct-to-consumer EWA models are treated under the prior guidance, which only dealt with employer-to-employee models.

In fact, the current CFPB has been urged to re-examine its position on EWA products and regulate them, and the CFPB has indicated that further guidance on these programs is forthcoming.[688]

Each year, the U.S. Department of Treasury issues its General Explanations of the Administration's Revenue Proposals, commonly known as the "Green Book." The Green Book issued in March 2022 for fiscal year 2023 contains a proposal related to EWA. Specifically, the Treasury Department recommends amending the Internal Revenue Code to expressly clarify that on-demand pay arrangements such as EWA are not loans. Whether or not this proposal will be adopted is unknown, but it does show a difference of opinion between two divisions in the Biden administration.

EWA allows employees to access earned wages prior to their pay date. Funds are usually deducted from the employee's next paycheck. EWA providers may work with employers or with employees directly. Fees may be charged but, unlike a loan, usually no interest is charged. Some industry players took the position that this product does not constitute credit because it is merely providing an advance on funds already earned. Some states have even passed laws to the effect that EWA products are not loans.[689]

The politicization of the CFPB is seen in treatment of EWA products. Under the Trump administration, the CFPB issued an advisory opinion that certain EWA products (offered in conjunction with employers) are not credit or subject to Truth in Lending Act provisions. But this interpretation appears to be rescinded by the promulgation of a rule by the CFPB in July 2024 finding that EWA products constitute

687 "Financial Technology: Products Have Benefits and Risks to Underserved Consumers, and Regulatory Clarity Is Needed." In addition to EWA the report covered digital deposit products offered by fintechs and banks, credit builder products to develop better credit files and scores, and small-dollar loans using alternative data.

688 It is noted that states are also involved in the regulation of EWA products. In general, California treats EWA as a loan requiring licensing and compliance with the state's lending law.

689 Nevada and Missouri approved laws distinguishing EWA products from loans. Wisconsin followed with its own law, and Kansas passed H.B. 2560, which was signed into law in April 2024. South Carolina enacted SB 700 in May 2024, which provides that there must be at least one option to receive wages at no cost.

credit and are subject to the provisions of the Truth in Lending Act and Regulation Z.[690] Further, expedited delivery fees and voluntary tips that consumers pay related to EWA products would constitute finance charges under the law and regulation. The proposed rule, if it becomes final, will subject EWA providers to disclosure and other requirements.

### C. Income Sharing Agreements (ISAs)

Another new and popular product is the Income Sharing Agreement (*"ISA"*). Oftentimes ISAs are used in connection with education or training programs where an individual is provided with an amount to pay tuition or other education-related expenses. Repayment of the amounts so provided is made only if the individual has subsequently (after the educational program has ended) obtained employment and then remits a specified amount or percentage (usually dependent on some calculation or income and/or expenses and perhaps subject to a floor or cap) until the original amount is repaid. Hence, if the individual never obtains employment, there is no obligation of repayment. These types of agreements were largely unregulated and touted as being an alternative to a loan.

However, on September 1, 2021, the CFPB issued a consent order against Better Future Forward, an ISA provider.[691] The CFPB found that ISAs are extensions of credit for purposes of the federal Truth in Lending Act and subject to the provisions of the law and regulations as a private education loan. As a result, Better Future Forward had failed to make the required disclosures and violated those provisions of law. Because the company had marketed its product as not being a loan, the agency found that Better Future Forward had engaged in deceptive practices.[692] As a result, it appears that ISAs need to comply with the applicable provisions of the federal Truth in Lending Act.[693] See the "Recent Developments in Marketplace Lending Regulation" section for further updates.

ISAs are used by professional and technical schools. The school provides a student with the cost of tuition in return for an ISA according to which the student agrees to pay the school a portion of their future income. There is typically no finance charge assessed, because there is arguably no obligation to repay; if the student never gets a job, the agreement was not considered to be a loan. The CFPB disagrees and deems ISAs to be loans subject to consumer protection laws. The agency has entered consent orders against four companies using ISAs.[694] The bureau seeks to impose liability on a variety

690 CFPB 2024-0032 (proposed rule July 31, 2024): "Truth in Lending (Regulation Z); Consumer Credit Offered to Borrowers in Advance of Expected Receipt of Compensation for Work." In January 2025, immediately before the Trump inauguration, the CFPB withdrew a 2020 advisory opinion that an EWA product was not a loan.

691 CFPB Admin. Proc. 2021-CFPB-0005 (Sept. 1, 2021).

692 The CFPB also found a Truth in Lending violation for charging prepayment penalties, which are prohibited on private education loans.

693 In January 2022, the CFPB updated its examination procedures manual for private student loans to specifically cover ISAs. The U.S. Department of Education's Office of Postsecondary Education issued an advisory to postsecondary schools about ISAs and compliance with private education loan laws and regulations.

694 *See, e.g.,* CFPB Administrative Proceeding File No. 2024-CFPB-0001 (Bloomtech, Inc.). The CFPB banned the school from engaging in any further consumer lending activities. The actions focus on for-profit educational institutions. In November

of theories, including failure to disclose terms as required by the Truth in Lending Act, and further finds such agreements to be subject to the FTC's Holder Rule.[695] The CFPB also entered into a consent order with an online arbitration company focused on the collection of income-sharing loans, including initiating proceedings without consent.[696]

### D. No-Interest Products with Voluntary Payments or Member/Subscription Fees

There are several programs in the marketplace offered by fintechs that provide funds to consumers but do not charge any interest. Many of these products, however, solicit tips or donations to be made on a voluntary basis for use of the product. The CFPB asserts that such products constitute loans and that tips and donations, even if voluntary, are finance charges. In May 2024, the CFPB filed an action against an online lending platform.[697] The company's marketing advertises "no interest" loans but borrowers may make a donation that is disclosed as being optional. The CFPB found that most loans had a donation or tip associated with them. The CFPB found donation options but no option for making no donation. The CFPB found that filing to disclose a tip or donation as a finance charge was an unfair and deceptive practice and that the loans are void because the company did not hold lending licenses or exceeded allowable usury rates. Claims similar to those brought by the CFPB have been made in litigation by consumers.[698]

Other programs make advances but may charge a periodic membership fee or subscription amount. Again, such fees are viewed as charges to obtain the funds and constitute lending and finance charges.[699] However, challenges in court are being made with respect to EWA fees.

### E. Enforcement Action

In November 2023, the CFPB issued a consent order against an online company.[700] In part, there were continuing violations of a prior CFPB order which resulted in a $15 million penalty as well as providing

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2023, the CFPB and 11 states obtained redress of $30 million from an ISA provider on similar theories as well as misrepresentations and collection practices. The company ceased operations as a result of the Consent Order. These actions follow the first CFPB proceeding on ISAs in 2021 against Better Future Forward, Inc., making similar allegations that ISAs constitute credit subject to consumer credit laws and regulations.

695 16 C.F.R. § 433.1 *et seq*.

696 *In re Ejudicate, Inc*., Admin. Proc. 2024-CFPB-0010 (Oct. 10, 2024).

697 *Consumer Fin. Prot. Bureau v. SoLo Funds, Inc*., Case No. 2:24-cv-4108 (C.D. Cal. filed May 17, 2024).

698 *Orubo et al. v. Activehours Inc.,* Case No. 5:24-cv-04792 (N.D. Cal.). The purported class action is based on payment of advance funds with no interest but optional fees and tips. The allegations include usury, violation of the Truth in Lending Act and Georgia's Payday Loan Act.

699 *See, e.g., Consumer Fin. Prot. Bureau v. Reliant Holdings, Inc. et al.,* Case No. 2:24-cv-01301 (W.D. Pa. filed Sept. 13, 2024) (monthly membership fee for limited-use credit card that was rarely used by consumers and misleading promotion of the product). The CFPB has also targeted fintechs working with banks on deposit account programs. In one instance, the CFPB found that timely refunds were not being made to customers who closed their online accounts. *In re Chime Fin., Inc.,* CFPB Consent Order; Adm. Proc. 2024-CFPB-0002 (May 7, 2024) ($3.25 million fine and $1.3 million redress to consumers).

700 *In re Enova Int'l, Inc.,* CFPB Adm. Proc. 2023-CFPB-0014 (Nov. 15, 2023).

for consumer redress. The crux of the action was that the fintech withdrew funds from borrowers' account without their permission and that loan extensions were not honored. The company was barred from offering loans of less than 45 days' duration and the agency required executive compensation to be tied to compliance.

All of the above indicate that innovations will continue to be reviewed and scrutinized in light of consumer protection laws with the bias toward making such products subject to existing regulatory schemes or creating new approaches to reach those products and services.

## F. Other Federal Regulatory Actions

### *1. FDIC and OCC Notices on Crypto Assets*

The FDIC issued notices of possible import to the marketplace lending industry most applicable to Funding Banks whose deposits are insured by the FDIC. In April 2022, the FDIC announced that FDIC-supervised institutions must notify the FDIC if they intend to engage in or are already engaged in activities related to crypto assets.[701] This includes providing the FDIC with information necessary to allow the FDIC to evaluate risk from this activity to the institution. The FDIC may then provide supervisory feedback to the institution.

> Regulators are looking to understand and regulate digital assets such as cryptocurrency.

The OCC has issued four interpretive letters on crypto-related matters.[702] These letters allow banks to engage in custodial services related to crypto assets as custody is a traditional banking activity performed electronically. They also allow banks to hold deposits serving as reserves for stablecoins on a one-to-one basis, based on banks' authority to receive deposits. Banks may use distributed ledgers and stablecoins to facilitate and engage in payment activities, as it is a modern form of traditional payment services. In connection with payment activities, banks may buy and sell electronically stored value to complete or facilitate payments. The OCC cautions that banks must be able to conduct these activities in a safe and sound manner satisfactory to the OCC. Like the FDIC, the OCC requires banks to notify the regulator of the proposed activity and receive regulatory notification of non-objection.[703]

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701 Fin. Inst. Letter No. 16-2022 (Apr. 7, 2022).

702 OCC Interpretive Letter No. 1170 (July 22, 2020) (custody of crypto assets); OCC Interpretive Letter No. 1172 (Sept. 21, 2020) (deposit reserves); OCC Interpretive Letter No. 1174 (Jan. 4, 2021); and OCC Interpretive Letter No. 1179 (Nov. 18, 2021).

703 On March 9, 2022, President Biden issued an executive order asking government agencies to examine the risks and benefits of digital assets such as cryptocurrency. Given the market imbalance in the spring of 2022, regulators were seeking authority over these types of assets and legislation was introduced in Congress to establish a new regulator that would focus on digital assets.

Given that cryptocurrency assets and programs are proliferating that could affect banks, Funding Banks and their service providers should be aware of these notice requirements.[704] These requirements also signal that not only are banking agencies aware of new innovations but they balance innovation with regulation and will engage in regulatory inquiry and scrutiny of new technological advances that affect safety and soundness, financial stability, and consumer protection.[705]

The FDIC has also issued cease-and-desist orders against companies who mislead consumers about the availability of insurance on cryptocurrency assets. While some programs are hybrid in that some funds are held at FDIC-insured institutions, the FDIC is critical of situations implying that the insolvency of a crypto company would be subject to insurance. Rather, FDIC insurance is only available in the event of a bank failure and only as to assets held at the federally insured depository institution.

The FDIC also updated its rule regarding the display of official signage including the FDIC logo, including in a digital environment.[706] Banks will be required to display a digital sign near their name on all digital platforms. The rule becomes effective May 1, 2025.

Many digital asset companies are seeking limited purpose trust national bank charters from the OCC which would avoid money transmission licensing at the state level.

The "Recent Developments in Marketplace Lending Regulation" section contains an update on digital assets and cryptocurrency and implications for the marketplace lending industry.

704 Similarly, the OCC issued an Interpretive Letter applicable to national banks and federal savings associations to notify the OCC of intention to engage in cryptocurrency, distributed ledger, and stablecoin activities. OCC Interpretive Letter No. 1179 (Nov. 18, 2021).

705 States are also looking to address this issue. For example, on April 11, 2022, Virginia enacted H.B. 263 (effective July 1, 2022), allowing a bank to provide virtual currency custody services if it can effectively manage associated risks and comply with law.

706 "FDIC Official Signs and Advertising Requirements, False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo" codified at 12 C.F.R. pt. 328, subpart A.

# More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. Please do not hesitate to reach out to book author Marc Franson, a member of our marketplace lending team, or any other Chapman attorney with whom you regularly work.

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# Appendix A

## Securities Laws, Bankruptcy Considerations, Tax Considerations, Blockchain and Crowdfunding Rules

This information can be found on our website at www.chapman.com.

# Appendix B

## About Chapman

Chapman and Cutler LLP has represented nearly every type of financial services entity, from hedge funds to specialty lenders, to some of the world's largest financial institutions. Our lawyers are actively involved in providing legal advice to and about marketplace lending programs.

***We Know Lenders.*** For decades, we have represented lenders in capital structures ranging from the straightforward to the complex. For us, representing lenders isn't just another service area—rather, representing lenders is at the heart of what we do every day. Our experience has helped us gain a thorough understanding of our clients' processes, products, and systems, as well as their market challenges and legal needs.

***Commitment to Value.*** We understand the evolving needs of financial services clients and skillfully combine legal acumen with business and market insight. Our commitment to value goes beyond closing a deal or resolving a matter—we share our market knowledge to help clients advance their own business goals.

***Depth of Knowledge.*** We have extensive experience representing Internet-based platforms engaged in consumer, student, and small business lending and providing other financial products. We have the experience needed to help our clients comply with the novel legal and regulatory issues presented by these programs and to assist with expanding funding sources.

***Comprehensive Counsel.*** With our singular focus on finance, Chapman has developed a deep bench of attorneys with the experience and skills necessary to tackle virtually any issue our clients may face. From beginning to end, Chapman provides a tailored, dynamic team of attorneys prepared to respond to any legal matter that may arise.

***Securitization Experience.*** Chapman has been at the forefront of the efforts to develop securitization structures for marketplace lending platforms. Our broad experience in asset-backed transactions enables us to provide effective advice to our clients in connection with this developing sector of securitizations. We represent sponsors, agent banks, and investors in securitizations of consumer Internet loans as well as lenders and institutional investors in connection with securitization warehouse facilities.

## Marketplace Lending Services

We handle funding arrangements for originators and purchasers of marketplace loans and also assist with development of programmatic whole-loan sale, servicing, and custodial agreements; due diligence and compliance reviews for investors; and assessment of federal and state regulatory requirements, including securities law compliance; lender, broker, and debt collector licensing requirements; usury and fee limitations; and disclosure, reporting, and fair lending regulations.

***Startup Advice.*** We advise startup online lenders (in both consumer and commercial loan segments) in connection with the negotiation of program/marketing, servicing, and loan sale agreements with originating bank partners.

***Issuance Program and Regulatory Advice.*** We advise online lenders interested in establishing notes issuance programs and we counsel all participants on compliance with applicable federal and state laws, rules, regulations, and requirements.

***Regulated Investment Companies and Private Funds.*** We represent regulated investment companies and private funds in connection with investments in marketplace lending products. We were the first to structure a closed-end fund filed with the SEC specializing in marketplace lending investments.

***Consumer Loans.*** We represent various online lenders and loan investors in connection with loan sale and servicing agreements and participation agreements.

***Small Business Loans.*** We represent online small business lenders in structured loan facilities and in the establishment of Internet-based notes issuance programs directed to individual and institutional accredited investors.

***Student Loans.*** We were among the first to structure capital markets-based financing solutions for marketplace education finance platform sponsors and we have recently been involved as either bank/issuer counsel or counsel to lenders and note purchasers for three newly formed marketplace student loan originators.

***Securitization.*** We represent issuers, platforms, and lenders/investors on a variety of warehouse and term securitizations of consumer loans, student loans, small business loans, and other asset classes.

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