How Rate Exportation Is Shifting Amid Regulatory Trends

By **Lisa Lanham, Ronald Vaske and Mindy Harris** (August 29, 2023)

Lisa Lanham

Ronald Vaske

Mindy Harris

States' efforts to impose controls on interest rate exportation through bank-fintech partnerships have been ramping up in recent years in the form of broad "anti-evasion" legislation and expanded licensing requirements.

In addition, there is revived interest in the ability of a state to opt out of decades-old federal law that permits interest rate exportation by state-chartered banks.

All lenders offering credit in multiple states through bank-fintech partnerships, and all state banks offering credit on an interstate basis, should be aware of these trends and evaluate the resulting risks on an ongoing basis.

A Brief History: The Case for Rate Exportation and Bank-Fintech Partnerships

Three materially identical federal statutes govern interest that may be charged by banks: Section 85 of the National Bank Act, which addresses the interest charges of national banks; Section 4(g) of the Home Owners' Loan Act, which covers the interest charges of federal and state savings associations; and Section 27(a) of the Federal Deposit Insurance Act, which governs the interest charges of state-chartered Federal Deposit Insurance Corp.-insured banks.

A series of U.S. Supreme Court and federal court decisions have interpreted these laws to permit banks to "export" interest rates and fees permitted by their home states when making interstate loans, regardless of the usury laws of the borrower's state of residence.[1]

There's nothing new about offering credit through strategic alliances between bank and nonbank third parties, but the proliferation of financial technology and lack of traditional credit alternatives available to the increasing unbanked population in recent years have created new opportunities for banks to expand their multistate lending programs through marketing and servicing arrangements with fintech companies.

In some instances, the fintech or another third party also serves as a liquidity source for the program. These bank-fintech partnerships give banks access to cutting-edge technology to better and more efficiently serve customers' needs and expectations, and enhance the economic viability of offering credit cards and other consumer loans, thus promoting broader access to consumer credit and expanding financial inclusion.[2]

The bank's ability to charge interest and fees as permitted by its home state on a uniform basis nationwide is an integral component of the bank-fintech partnership's economic structure.

Some state financial regulators and private plaintiffs have challenged banks' ability to

export interest rates, both within and outside of the context of a bank-fintech partnership.[3] In the context of a bank-fintech partnership, opponents typically argue that the fintech, not the bank, is the "true lender," and, therefore, the bank's authority should not apply and uniform interest rates cannot be exported.

However, until recently, with a few exceptions,[4] state statutes generally did not expressly support this position.

"Anti-Evasion" Statutes and Similar Laws

In March 2021, Illinois adopted the Illinois Predatory Loan Prevention Act, which established a 36% all-in annual percentage rate limit on all consumer loans made in Illinois, and contained what was then the most aggressive anti-evasion provisions of any statute nationwide.

The PLPA provides that a bank's agent is the actual lender on a loan when the agent "holds, acquires, or maintains, directly or indirectly, the predominant economic interest in the loan" or "markets, brokers, arranges, or facilitates the loan and holds the right, requirement, or first right of refusal to purchase loans, receivables, or interests in the loans."

Per this statute, the loan is deemed to be made by the nonbank agent if "the totality of the circumstances indicate that [it] is the lender and the transaction is structured to evade the requirements of this Act."

Circumstances the PLPA identifies as weighing in favor of a nonbank agent being the lender include the agent's provision of any indemnification to the bank, the agent's predominant design, control or operation of the program or the agent's activity as a lender in other states.

Maine quickly followed suit with similar legislation in June 2021.

A Hawaii law adopted effective January 2022 includes a broad definition of "Installment Lender" that may purport to subject loans made using a bank-fintech partnership model to the Hawaii Installment Loans Law.

Effective in 2023, three more states have enacted laws similar to the Illinois PLPA. New Mexico, Connecticut and Minnesota all have added statutes that generally provide that a bank's nonbank partner is the actual lender when the nonbank holds or acquires the predominant economic interest in the loans, or markets, arranges, or facilitates the loans, and/or provides that the loan is deemed to be made by the nonbank if "the totality of the circumstances" indicates that the nonbank is the lender and the transaction is structured to evade the requirements of the statute.

Some of the statutes mentioned above also expand licensing requirements to encompass fintech partners.

The increase in state legislative activity described above points to a desire on the part of state lawmakers to increase their control over the interest rates payable by state residents. The laws described above could be utilized to disallow interest rate exportation by national banks, federally chartered savings and loan associations, and state-chartered banks if the lender utilizes a bank-fintech partnership and the fintech is found to be the so-called true lender based on application of the statute.

While true lender cases continue to be brought by state attorneys general and private plaintiffs in courts around the country, with varying results,[5] these new statutes may lend added support to bank-fintech partnership opponents in the states in question.

Other states are taking legislative or enforcement approaches that do not seek to re-characterize the fintech partner as a lender, but impose licensing requirements on the fintech — and any other entity participating in, or involved in the marketing or servicing of, loans.

For example, in June, Nebraska's Installment Loan Act licensing requirement was expanded to apply to "any person that is not a financial institution who, at or after the time a loan is made by a financial institution, markets, owns in whole or in part, holds, acquires, services, or otherwise participates in such loan."

Accordingly, in states like Nebraska, a fintech will need to bear the burden of maintaining a state license in order to engage in its limited origination activities, including the costs of initial licensing and renewing the license, periodic reporting requirements, and regulatory examinations.

Moreover, state licensing agencies have broad authority to review the business activities of their licensees, which potentially provides them with visibility into the activities of the partner banks, including interest rates imposed. It provides such agencies with a bit of a back door to regulate partner banks and change the landscape of the industry.

Opting Out of State Bank Rate Exportation

Another development, suspected by some to herald a nascent trend, involves the decades-old right of states to opt out of Section 27(a) of the FDIA,[6] which advocates claim would block the right of out-of-state state banks to export their home-state rates into the opt-out state. The opt-out would have no effect on the rate-exportation powers of national banks or federally chartered savings associations.

Until earlier this year, Iowa and Puerto Rico were the only jurisdictions with existing opt-out legislation in place — originally adopted in 1980. In June, Colorado enacted opt-out legislation, to be effective in July 2024. In recent months, Iowa has quietly increased its enforcement efforts against rate exportation by out-of-state state banks.

However, the effects of the Iowa opt-out and the not-yet-effective Colorado opt-out statute have not been determined in a court, and remain to be seen.

Other Challenges

While not addressed here, lenders and their fintech partners should be aware that federal regulators like the Office of the Comptroller of the Currency, FDIC, the Federal Reserve Board and the Consumer Financial Protection Bureau have issued guidance and, in some cases, have engaged in enforcement actions and litigation, in connection with bank-fintech partnerships.[7]

Next Steps

As suggested above, if they wish to engage in lending to borrowers in multiple states and charge uniform interest rates, all banks and fintechs that partner with banks should pay heed to these and related developments, and determine how best to mitigate risks to their

efforts to offer credit to consumers on a nationwide basis.

Fintechs, in particular, should keep abreast of any changes that impose a new licensing requirement and review the full text of any such laws for the impacts on their business activities. It is a quickly evolving area of law, and it should be approached with caution.

Lisa M. Lanham is a partner and co-leads the fintech and payments solutions team at Ballard Spahr LLP.

Ronald K. Vaske is a partner and co-leads the fintech and payments solutions team at the firm.

Mindy Harris is of counsel at the firm.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] See, for example, Marquette National Bank v. First of Omaha Service Corporation, 439 U.S. 299 (1978); Greenwood Trust v. Massachusetts, 971 F.2d 818 (1st Cir. 1992).

[2] See U.S. Department of the Treasury, Report: A Financial System That Creates Economic Opportunities, Nonbank Financials, Fintech, and Innovation (July 2018) https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf , at p.11: "Marketplace lenders are expanding access to credit for consumers and businesses in the United States. Treasury recognizes that partnerships between banks and marketplace lenders have been valuable to enhance the capabilities of mature financial firms. Treasury recommends eliminating constraints brought about by recent court cases that would unnecessarily limit the functioning of U.S. credit markets. Congress should codify the "valid when made" doctrine and the role of the bank as the "true lender" of loans it makes. Federal banking regulators should also use their available authorities to address both of these challenges."

[3] Other theories put forth to challenge rate exportation include the claim that sale of a loan defeats the purchaser's ability to continue charging the rate validly charged by the originating bank, see Madden v. Midland Funding LLC, 786 F.3d 246 (2d Cir. 2015). Both the OCC and the FDIC have adopted Valid-When-Made ("Madden-Fix") regulations to contravene the Madden holding.

[4] Laws dating back to 2004 (Georgia), 2005 (Nevada) and 2016 (New Hampshire) targeted specific situations such as payday loans and other high-rate loans.

[5] Many "true lender" cases have been brought in the absence of supporting statutes. For example, the Colorado AG sued two fintechs on true lender theories (these lawsuits settled in 2020); the California DFPI currently is seeking a court order to make a fintech stop facilitating its bank partner's loans to California borrowers at interest rates permitted by the lender's state, but not permitted by the California financing law. Neither of these states have anti-evasion or "predominant economic interest" laws.

[6] See Section 525, Depository Institutions Deregulation and Monetary Control Act of 1980.

[7] See, for example, https://www.consumerfinancemonitor.com/2022/11/07/occs-new-office-of-financial-technology-portends-increased-supervisory-activity/ ; https://www.consumerfinancemonitor.com/2022/11/22/treasury-report-on-bank-fintech-relationships-includes-recommendations-for-cfpb-supervision-of-non-bank-installment-lenders-and-data-aggregators/.