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PREEMPTION OF STATE INTEREST RATE LIMITATIONS: CURRENT CHALLENGES INVOLVING BANK PARTNERSHIP MODELS

Federal preemption of state usury laws is currently under attack by "true lender" theories. The author discusses the statutory and regulatory background of preemption and "true lender" challenges to bank partnership models. She then argues that preemption should apply to any loan for which a bank contracts and provides funds to the borrower. Widespread adoption of the alternative "true lender" framework, she argues, would undermine the liquidity that is essential to a robust lending market.

By Ashley M. Simonsen *

National banks have the power under the National Bank Act ("NBA") to make loans at the rate of interest allowed by the laws of their home states, without regard to other state law interest rate limitations, such as usury laws. State-chartered banks that offer deposits insured by the Federal Deposit Insurance Corporation ("FDIC") have the same power under Section 27 of the Federal Deposit Insurance Act ("FDIA"). Claims asserted against banks under the usury laws of other states (besides their home states) are preempted under these statutes. Moreover, under the "valid-when-made" rule, state laws that would be preempted in a lawsuit against a bank are also preempted in a suit against the bank's assignee.

These clear, predictable, uniform rules provide the structure and framework upon which banks and loan purchasers have depended for more than 150 years to make and sell interstate loans. Nevertheless, in recent years, state regulators and private plaintiffs have attempted to circumvent and undermine this regime of legal certainty by arguing that preemption should apply *only* if — after applying a fact-intensive, multi-factor test — the bank is determined to be the "true lender" on the loan. Citing a handful of lower court decisions that have endorsed this totality-of-the-circumstances approach to determining the lender on a loan, these litigants have sought to attack bank partnership models in which third parties provide origination and other

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services to state- or federally chartered banks, and then purchase loans made by the banks shortly after origination. Many have also embraced a widely criticized Second Circuit decision, *Madden v. Midland Funding, LLC*,[1] which declined to recognize the valid-when-made rule, to argue that the mere assignment of a loan to a third party eviscerates its preempt status.

On November 18 and 19, 2019, the Office of the Comptroller of the Currency ("OCC") and the FDIC provided long-awaited regulatory affirmation of the valid-when-made rule, proposing regulations that — as the OCC put it — would "clarify that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer."[2] However, while affirming that a loan valid when made remains valid after assignment, the agencies expressly declined to address "which entity is the *true lender* when a bank makes a loan and assigns it to a third party."[3] In other words, they declined to address the circumstances in which a loan is "made" by a national or state-chartered bank in the first place, such that state interest rate laws are preempted and the loan is "valid" to begin with.

As explained below, the "true lender" theory advanced by state regulators and private plaintiffs is inconsistent with governing federal precedent and, if broadly accepted, would introduce a level of uncertainty and unpredictability into the marketplace, threaten to undermine the fundamental economics upon which modern credit markets are based, and harm lenders, borrowers, and the economy in general. For these very reasons, the U.S. Department of the Treasury called upon Congress last year to reconfirm the role of the bank in bank partnership models as the "true lender," recognizing that the "constraints brought about by recent court cases . . . would unnecessarily limit the functioning of U.S. credit markets."[4] Although a bill was introduced in the U.S. House of Representatives in 2017 to "clarify that Federal preemption of State usury laws applies to any loan to which an insured depository institution is the party to which the debt is initially owed according to its terms, and for other purposes,"[5] it has not been enacted. In the face of legal uncertainty and Congressional inaction, the OCC and FDIC should extend their proposed rulemaking to affirm not only the valid-when-made principal, as they did in late 2019, but also the identity of originating banks as "true lenders" on loans they make.

BACKGROUND

Statutory and regulatory background

Section 85 of the NBA expressly grants a national bank the power to "charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located."[6] It is well settled that section 85 preempts any other state law that purports to limit the interest charged on loans made by a national bank, such as usury laws.[7] Indeed, the "impairment" of state usury laws "has always been implicit in the structure of the National Bank Act."[8] "Uniform rules limiting the liability of

[1] 786 F.3d 246 (2d Cir. 2015), *cert denied*, 136 S.Ct. 2505 (2016).

[2] OCC, Notice of Proposed Rulemaking, Permissible interest on loans that are sold, assigned, or otherwise transferred, RIN 1557-AE73 (Nov. 18, 2019) ("OCC Proposed Rulemaking"); *see also* FDIC, Notice of Proposed Rulemaking, Federal Interest Rate Authority, RIN 3064-AF21 (Nov. 19, 2019) ("FDIC Proposed Rulemaking") (proposing regulations clarifying that "whether interest on a loan is permissible . . . would be determined at the time the loan is made" and "would not be affected by subsequent events, such as . . . the sale, assignment, or other transfer of the loan").

[3] OCC Proposed Rulemaking, *supra* note 2 (emphasis added); *see also* FDIC Proposed Rulemaking, *supra* note 2 (declining to address whether a bank "is a real party in interest with respect to a loan or has an economic interest in the loan under state law, *e.g.*, which entity is the 'true lender'").

[4] U.S. Dep't of Treasury, *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* (July 2018) at 11, 93, *available at* https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf (hereinafter "2018 Treasury Report").

[5] Modernizing Credit Opportunities Act of 2017, H.R. 4439 (115th Congress, 2017-2018), *available at* https://www.congress.gov/bill/115th-congress/house-bill/4439/text (hereinafter "H.R. 4439").

[6] 12 U.S.C. § 85; 12 C.F.R. §§ 7.4001(b), 7.4008(d)(10).

[7] *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 313-14 (1978).

[8] *Id.* at 318.

national banks and prescribing exclusive [federal] remedies for their overcharges are an integral part of a banking system that needed protection from possible unfriendly State legislation."[9]

In 1980, recognizing a need to "prevent discrimination against state-chartered" banks, Congress enacted section 27 of the FDIA to grant them the same protections.[10] Like section 85 of the NBA, section 27 of the FDIA preempts state interest rate caps — other than the caps imposed by the bank's home state — as to "any loan . . . made" by a state-chartered bank.[11] These two sections are "virtually identical in substance, policy, and internal logic," and "the same express preemption analysis governing Section 85 . . . of the National Bank Act applies to preemption of state usury laws under Section 27 of the FDIA."[12]

The power explicitly conferred upon banks to make loans at the maximum interest rate allowed by their home states includes the power to transfer a loan, including its interest rate term, to an entity other than a state- or federally-chartered bank. Often referred to as the "valid-when-made" rule, this means state laws that would be preempted in a suit against the bank are also preempted in a suit against the assignee of a loan made by a bank.[13] Although the Second Circuit's 2015 *Madden* decision cast doubt on this rule, that decision has not been adopted by other courts and has been widely criticized, with the OCC and FDIC declaring in a September 2019 amicus brief that "*Madden*'s disregard of two centuries of established law — without even addressing such law — is not just wrong: it is unfathomable."[14]

Shortly thereafter, in November 2019, the OCC and FDIC issued proposed rulemaking, affirming that a loan that is valid when made remains valid after assignment.[15] These rules seek, as the OCC put it, to "codify what the OCC and the banking industry have always believed and address recent confusion about the impact of an assignment on permissible interest."[16] However, the OCC and FDIC expressly declined to address the circumstances in which a loan is "valid" in the first place because the "true lender" that "made" it is a national or state-chartered bank — meaning that state interest rate limitations are preempted.

"True Lender" Attacks on Bank Partnership Models

In recent years, state regulators and private plaintiffs have sought to attack bank partnership models, including marketplace lending arrangements, by arguing that the "true lender" on the loans is *not* the bank that issued the loans, but rather a third party involved in their origination and sale. Unlike *Madden*-type challenges, "true lender" challenges accept that a loan that is valid when made remains valid after assignment. They instead posit that the involvement of a non-bank in the origination and sale of the loan makes it — not the bank — the "true lender," such that federal preemption does not apply, and the loan is not "valid" in the first place. Two actions pending in Colorado state court against marketplace lenders Marlette Funding LLC ("Marlette") and Avant of Colorado LLC ("Avant") are illustrative of these types of challenges.[17]

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[9] *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10 (2003) (internal marks omitted).

[10] 12 U.S.C. § 1831d(a).

[11] *Id.*

[12] *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359, 1363 (D. Utah 2014) (internal marks omitted); *see also Greenwood Trust Co. v. Commw. of Mass.*, 971 F.2d 818, 827 (1st Cir. 1992) (holding that these provisions "should be interpreted the same way"); FDIC, Interpretive Letter No. 93-27, 1993 WL 853492, at *1 (July 12, 1993) (similar).

[13] *See, e.g.*, *Krispin v. May Dep't Stores Co.*, 218 F.3d 919, 924 (8th Cir. 2000) (courts must "look to the originating entity (the bank), and not the ongoing assignee . . . in determining whether the NBA applies"); *see also* Brief for the United States as *Amicus Curiae*, *Midland Funding, LLC* v. *Madden*, 2016 WL 2997343, at *7-8 (U.S. May 24, 2016) ("Under the long-established 'valid-when-made' rule, if the interest rate term in a bank's original loan agreement was non-usurious, the loan does not become usurious upon assignment, and so the assignee may lawfully charge interest at the original rate.") (hereinafter "OCC/SG Brief"); Br. Amicus Curiae of the FDIC and the OCC, *In re Rent-Rite Superkegs West Ltd. v. World Lenders, LLC*, 2019 WL 4569774 (D. Colo. Sept. 10, 2019) (affirming that the NBA and FDIA "allow banks to transfer their rates to assignees") (hereinafter "OCC/FDIC Brief").

[14] OCC/FDIC Brief, *supra* note 13; *see also* OCC/SG Brief, *supra* note 13, at *6, *12-*13 (calling *Madden* "incorrect" and "misconceived"); 2018 Treasury Report, *supra* note 4, at 93 (recommending that Congress "codify the 'valid-when-made' doctrine" and that federal regulators "use their available authorities to address challenges posed by *Madden*").

[15] OCC Proposed Rulemaking, *supra* note 2; FDIC Proposed Rulemaking, *supra* note 2.

[16] OCC Proposed Rulemaking, *supra* note 2.

[17] *Meade v. Marlette Funding LLC*, No. 17CV30376 (D. Colo. 2017); *Meade v. Avant of Colorado LLC*, No. 17CV30377 (D. Colo. 2017).

In early 2017, the State of Colorado sued Marlette and Avant, charging the marketplace lenders with charging interest in excess of Colorado's limits for finance and delinquency charges. The loan fees at issue in both cases are considered "interest" within the meaning of section 27 of the FDIA and section 85 of the NBA.[18]

The loans at issue in *Marlette* were made by Cross River Bank, a state-chartered, FDIC-insured bank in New Jersey that originates loans to individuals, including Colorado consumers. Cross River Bank contracted with Marlette to market, operate a website for, and help process unsecured consumer installment loans that Cross River Bank originated. In its program with Marlette, Cross River Bank identified itself in all of its loan agreements as the lender on the loans. Cross River Bank fully funded all of the loans. It then held approximately 10% of the loans for its own investment, and sold others to Marlette or other third parties after holding them for at least two days. For the loans it sold, Cross River Bank continued to share a 1% interest in the economic performance of the loans on an ongoing basis.[19]

The loans at issue in the *Avant* case were made by WebBank, a Utah-chartered industrial bank. Avant's partnership with WebBank was similar to Marlette's partnership with Cross River Bank, except that WebBank sold 100% (rather than 90%) of its loans to Avant and its affiliates.[20]

After Marlette and Avant bought the loans, they collected finance and delinquency charges from borrowers that were permitted under the loan agreements. The State of Colorado does not contend that these charges exceeded the interest rate limitations imposed by New Jersey or Utah (the laws of the states where the banks are chartered); rather, the State asserts that these charges violated Colorado law. Anticipating Marlette's and Avant's preemption defense under section 27 of the FDIA, the State alleges that preemption does not apply because Cross River Bank and WebBank are not the "true lenders" on the loans. This is so, the State posits, because the banks knew in advance that Marlette and Avant had sufficient funds to purchase the loans and shared only 1% of the total profit, and because Marlette and Avant raised capital to "fund the origination" of the loans; purchased the loans within two days after they were made; and paid costs associated with marketing the loans and determining which applicants would receive loans (applying lending criteria agreed to by the banks).[21]

On August 13, 2018, the court in *Avant* and *Marlette* denied the marketplace lenders' motions to dismiss on grounds of federal preemption, holding that the State of Colorado had "set forth detailed allegations which state plausible claims that Marlette and Avant each has the predominant economic interest in the loans made to Colorado consumers at issue in these cases, and that they, not the bank in whose name the loans were originally made, are the de facto lenders."[22] The cases are set for trial beginning in April 2020.

ARGUMENT AND ANALYSIS

The interest rate and preemption rules established under the NBA and FDIA have created a robust nationwide system of lending that is critical to the national economy and to financial services innovation. Central to this system is the existence of a clear, predictable, and uniform set of rules governing interest rates and fees. These bright-line rules foster liquidity in the marketplace, maximizing the availability of credit that drives the nation's economy, and reducing transaction costs that might otherwise increase the cost of credit.

The "true lender" theory advanced by the State of Colorado and other litigants as a basis for avoiding federal preemption is inconsistent with this regime of legal certainty. By advocating for a multi-factor test that requires evidentiary showings and complex judicial evaluation, these litigants are pursuing an approach that would drain certainty from the marketplace. This approach is not only inconsistent with preemptive federal law; it also threatens to undermine the fundamental economics upon which modern credit markets are based and would harm lenders, borrowers, and the economy in general. For this reason, the OCC and FDIC should extend their recent proposed rulemaking on the valid-when-made rule, and affirm the role of originating banks as the "true lenders" on the loans they make.

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[18] *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 741-42, 744-45 (1996); *Stoorman v. Greenwood Trust Co.*, 908 P.2d 133, 135 (Colo. 1995).

[19] *Marlette*, Am. Compl. (Feb. 15, 2017) ¶¶ 7, 12, 24-26, 28, 32(i).

[20] *Avant*, Am. Compl. (Feb. 15, 2017) ¶¶ 7, 25, 27-28, 34(o).

[21] *Marlette*, Am. Compl., *supra* note 19, ¶ 32; *Avant*, Am. Compl., *supra* note 20, ¶ 34.

[22] *Meade v. Marlette Funding*, 2018 Colo. Dist. LEXIS 1183, at *48 (Colo. D. Ct. Aug. 13, 2018).

Preemption applies to any loan for which a bank contracts and provides funds to the borrower.

It is undisputed that federal preemption applies, at least in the first instance, to the interest rate charged on any loan made by an FDIC-insured, state-chartered bank or a national bank. Indeed, it is for this reason that litigants challenging bank partnership models contend that the bank's partner, not the bank, should be treated as if it were the "true lender" on the loans.

In ordinary parlance, the "lender" on a loan is the entity that (a) contracts with the borrower for the loan and (b) supplies the loan funds.[23] That is precisely the test that properly applies in determining the lender on a loan for federal preemption purposes. As multiple courts have held, the NBA and FDIA provide "no basis" to "draw boundaries between federal and state bank regulation depending upon . . . the precise extent of financial risk" borne by the bank.[24] The extent of risk retained by the bank simply "does not alter the fact that" it is the "real party in interest" for purposes of NBA and FDIA preemption.[25] Instead, the "dispositive" question in determining whether state usury law is preempted is whether a bank literally made the loan — *i.e.*, contracted with and supplied the loan funds to the borrower.[26]

In most of the cases relied upon by litigants seeking to advance "true lender" theories, the courts improperly relied on "substance-over-form" tests formulated under *state* law that were designed to address very different questions and that have no application to federal preemption under the NBA or FDIA.[27] Indeed, it is black-letter *federal* law that "state laws which interfere with, or are contrary to the laws of Congress, made in pursuance of the constitution, are preempted and, therefore, invalid."[28] For this reason, the FDIA (like the NBA) "necessarily derails any state-sponsored attempt to regulate the maximum interest chargeable by a federally insured bank chartered in another state."[29]

These alternative tests for determining the lender on a loan, if broadly adopted, would subject loans made by federal and state-chartered banks to potential challenges under the usury laws of 50 states depending on a variety of potential factors, such as how quickly the loans were assigned or transferred from their balance sheets. Such tests, which offer no bright-line rules that can be applied based on easily determined objective facts, would thwart Congress's purpose of creating certain and uniform lending rules. Indeed, banks could hardly exercise their federal authority to make loans if the exercise of that authority were constantly subject to complex fact-intensive inquiries far afield from the terms of the loan transactions themselves.[30]

The better-reasoned decisions addressing this issue have consistently rejected the undermining of federal preemption through vaguely defined "true lender" tests. For example, in *Hudson v. Ace Cash Express, Inc.*, the

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[23] *See, e.g.*, Lender, *Black's Law Dictionary* (10th ed. 2014) ("A person or entity from which something (esp. money) is borrowed.").

[24] *Hudson v. Ace Cash Express, Inc.*, 2002 WL 1205060, at *6 (S.D. Ind. May 30, 2002); *see also Sawyer*, *supra* note 12, at 1366-67 (applying preemption to loans originated by state-chartered bank "based on the analogy of Section 27" to section 85).

[25] *Krispin*, *supra* note 13, at 923-24.

[26] *Hudson*, *supra* note 24, at *7; *see also Krispin*, *supra* note 13, at 924; *Phipps v. FDIC*, 417 F.3d 1006, 1013 (8th Cir. 2005) (where plaintiffs' loan documents acknowledged that national bank "was the lender that funded and made the loans," preemption applied); *Sawyer*, *supra* note 12, at 1369; *Discover Bank v. Vaden*, 489 F.3d 594, 602-3 (4th Cir. 2007) (state usury claims preempted where loan contracts "conclusively demonstrate that [bank] was the entity that extended [plaintiff] credit and set the interest and fees of which [plaintiff complains"), *rev'd on other grounds*, 556 U.S. 49, 53-54, 56 n.4 (2009).

[27] *See, e.g.*, *CashCall, Inc. v. Morrisey*, 2014 WL 2404300 (W. Va. May 30, 2014), at *14-15 & n.19 (deriving a "predominant economic interest test" from state usury law, and explicitly declining to apply a "federal law test"); *see also Meade*, *supra* note 22, at *32-*35, *47-*48, *52 (holding that "Colorado appellate courts would look to the substance of the loans and the relationships between Marlette/Cross River and Avant/WebBank" in determining whether federal preemption applies, following *Morrisey*); *compare Beechum v. Navient Solutions, Inc.*, 2016 WL 5340454, at *6-7 (C.D. Cal. Sept. 20, 2016) (rejecting effort to use state law "substance-over-form" test, holding it was not applicable to state usury law exemption for loans made by banks and that "the Court must look only to the face of a transaction" in determining whether such an exemption applies).

[28] *Greenwood Tr.*, *supra* note 12, at 822 (internal quotation marks omitted) (holding that FDIA preempted Massachusetts's usury statute).

[29] *Id.* at 827; *see also Beneficial Nat'l Bank*, *supra* note 9, at 10; *Marquette*, *supra* note 7, at 318.

[30] OCC/SG Brief, *supra* note 13, at *8 ("A national bank's federal right to charge interest up to the rate allowed by Section 85 would be significantly impaired if the national bank's assignee could not continue to charge that rate").

plaintiff sued a non-bank, ACE, for usury under Indiana law. A national bank, Goleta, funded the plaintiff's loan and was identified as the lender on the promissory note, but then sold a 95 percent interest to ACE pursuant to a separate agreement. ACE was solely responsible for collecting loan payments and charging fees.[31] The plaintiff argued that ACE should be treated as the "actual lender" given Goleta's "insignificant" role in the lending program, and that the NBA should be construed therefore not to apply.[32] The court rejected this argument, finding no statutory basis for "drawing jurisdictional boundaries in such an uncertain and unpredictable way."[33] Rather, the fact that Goleta had "made the loan to [the plaintiff]" was "dispositive."[34]

In support of its conclusion, the *Hudson* court cited *Krispin v. May Department Stores Co.*, in which the Eighth Circuit had similarly held that the plaintiff's claims were subject to NBA preemption, even though the bank issuing the credit "held no financial stake in the loans," having sold them to a non-bank assignee on a daily basis.[35] Applying *Krispin*, the *Hudson* court had no difficulty concluding that even if ACE's participation interest had been 100 percent, that would "not affect the controlling legal issue" and section 85 would still apply.[36]

The court in *Sawyer v. Bill Me Later, Inc.* also easily rejected the plaintiff's argument that an FDIC-insured state bank was not "the true lender or the real party in interest" on his loan, where the bank was the party to the loan contract, funded the loan, and held the loan for two days before selling it to a non-bank service provider.[37] As the *Sawyer* court reasoned, "concerns about protection of state usury laws present questions of legislative policy better addressed by Congress."[38]

In bank partnership models and marketplace lending arrangements like those challenged in *Marlette* and *Avant*, the federal or state-chartered FDIC-insured banks are the lenders and counterparties on the loan contracts with borrowers, and extended the funds for the loans. These facts should be dispositive in identifying the banks as the lenders, meaning that federal law preempts any application of state usury law (other than the law of the bank's home state) to the loans. As Treasury recognized in its 2018 Report urging Congress to reconfirm that banks in marketplace lending arrangements are the true lenders, "federal law allows the bank, and federal jurisprudence allows the marketplace lender servicing the loan, to charge interest at the rate allowed by the laws of the state where the bank is located, even if the rate is higher than the rate allowed under the laws of the state where the loan is made."[39]

The mere fact that the banks in these lending arrangements know in advance that their non-bank partners have sufficient funds to purchase the loans, as litigants often highlight, is unremarkable, and certainly provides no basis for determining that the banks are not the "lenders." Although the banks typically recoup the amount advanced to fund a given loan some days after making it (through the sale of the loan or an interest in the loan), those sale proceeds are not available to the banks *before* they provide the loan funds to the borrower. For purposes of funding the loan to the borrower, therefore, the bank has to rely on other sources of capital, such as borrower deposits or proceeds from the sale of *different* loans. By contrast, in many of the cases relied upon by "true lender" advocates like the State of Colorado, it was not clear that the banks had in fact funded the loans at issue.[40]

The fundamental problem with "true lender" tests becomes crystal clear when one considers how the customary approach to identifying a "lender" would apply to third parties like Avant and Marlette — the entities that the State of Colorado wishes to identify as the "true" lenders. It is undisputable that these third

[31] *Hudson*, *supra* note 24, at *1-3.

[32] *Id.* at *4.

[33] *Id.* at *6.

[34] *Id.* at *7.

[35] *Id.* at *5-6 (citing *Krispin*, *supra* note 13, at 924).

[36] *Id.* at *3 n.1, 6; *cf. Student Loan Marketing Ass'n v. Riley*, 112 F. Supp. 2d 38, 44 (D.D.C. 2000) (entity issuing credit did not "shed its status as the lender" by allegedly retaining no financial risk on loans it sold) (hereinafter "*SLMA*").

[37] *Sawyer*, *supra* note 12, at 1360-61, 1367-69.

[38] *Id.* at 1367.

[39] 2018 Treasury Report, *supra* note 4, at 88.

[40] *See, e.g.*, *CFPB v. CashCall, Inc.*, 2016 WL 4820635, at *2, *6 (C.D. Cal. Aug. 31, 2016) (non-bank deposited money into account "to fund consumer loans"); *Pennsylvania v. Think Fin., Inc.*, 2016 WL 183289, at *1, *12 (E.D. Pa. Jan. 14, 2016) (non-bank allegedly funded loans); *Ubaldi v. SLM Corp.*, F. Supp. 2d 1190, 1195 (N.D. Cal. 2012) (bank allegedly did not fund loans); *People v. Cty. Bank of Rehoboth Beach*, 846 N.Y.S.2d 436, 438 (2007) (non-banks "opened and maintained a funding account which, at all times, had sums in excess of the daily amount needed to fund the loans"); *see also Sawyer*, *supra* note 12, at 1370 (distinguishing *Ubaldi* because the plaintiff disputed that the bank had funded the plaintiff's loan).

parties are *not* the counterparties to the lending agreements with the borrowers. They make no binding commitments to loan money to the borrowers; nor do they do so. Whatever activities they might engage in more generally in connection with the banks' lending programs, their involvement with the loan transactions themselves satisfy *none* of the ordinary, transparent, and common-sense criteria for identifying the "lender" on a loan.

Under "true lender" tests, no one could simply examine loan documents and the transmission of loan proceeds to determine who the "lender" is on a loan and whether the interest rate charged was accordingly valid. Instead, these complex multi-factor tests can only be resolved through intensive and costly fact-finding in a judicial proceeding. Determining applicable law under such tests would require a lengthy analysis of literally trillions of credit transactions occurring every year. Such tests offers no certainty or transparency — none of the factors critical to enabling the interstate banking activity that the NBA and FDIA were designed to promote. They are thus inconsistent with the fundamental purpose of these federal laws as well as with their explicit directives.

Broad adoption of "true lender" theories would introduce uncertainty into the regulatory regime, undermining the liquidity that is central to a robust lending market.

Ultimately, "true lender" theories threaten substantial harm to lenders, to purchasers of loans, and also to consumers, because they seek to impose an inherently unpredictable test for legality that would make much consumer lending impractical.

Selling loans is a basic activity engaged in by nearly all banks to manage their balance sheets.[41] Selling loans allows banks to make more loans than they are able to hold and to move lower-yielding loans off their balance sheets to make room for better assets when opportunities arise. Indeed, the vast majority of all loans made in the United States today are originated by parties that sell the loans to investors, often packaged in asset-backed securities. About $13 billion in asset-backed securities supported by marketplace loans were originated in 2017.[42] Selling loans is a mainstream process — not some unusual or improper practice, as "true lender" proponents imply.

Banks' ability to sell loans generates liquidity in lending, which leads to broader availability of credit, which in turn drives economic growth.[43] Such liquidity requires clear, predictable, uniform rules confirming the validity of a loan's terms, including interest rates and other charges. When a bank enters into contracts to make loans and to supply loan funds to borrowers, it needs complete assurance of the applicable laws (including usury laws). Such assurance facilitates the ready sale of loans to third-party buyers, providing a framework on which banks and loan purchasers have long depended.

Any state law purporting to regulate the interest charged on a loan depending on the identity of the party with the "predominant economic interest" in the loan (as many "true lender" litigants, including the State of Colorado, argue) would inject uncertainty and unpredictability into this framework, hampering the liquidity that is central to banks' functioning and borrowers' access to credit. As Treasury explained in its recent Report, "compliance with such a standard on an ex-ante basis could be difficult because of nuances in how a court might determine the predominant economic interest."[44] Such a "fragmented legal structure creates an inefficient regulatory framework and significant compliance challenges for the bank partnership model."[45] The resulting harm would not be limited to

[41] *See generally* OCC, *Mortgage Banking Comptroller's Handbook* 3 (Feb. 2014) ("Banks participate in the secondary market to gain flexibility in managing their long-term interest rate exposures, to increase liquidity, manage credit risk, and expand opportunities to earn fee income."), *available at* https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/mortgage-banking/pub-ch-mortgage-banking.pdf.

[42] 2018 Treasury Report, *supra* note 4, at 88-89 (discussing the growth of marketplace lending volumes and the corresponding securitization market).

[43] *See generally* U.S. Dep't of Treasury, *Opportunities & Challenges in Online Marketplace Lending* 3 (2016) ("Access to credit is the lifeblood of business and economic growth."), *available at* https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

[44] 2018 Treasury Report, *supra* note 4, at 93.

[45] *Id.*; *see also Parks v. MBNA Am. Bank, N.A.*, 54 Cal. 4th 376, 393 (2012) ("[p]reemption rulings based on 'factual evidence' for a particular defendant bank . . . will have little value — even for a single bank — much less for many or all national banks." (quoting *amici curiae* American Bankers Association and California Bankers Association)); H.R. 4439, Findings ("Inconsistencies in the determinations of the identity and location of the lender under judicially crafted multi-factor balancing tests lessen the efficiency of the lending process, reduce the transparency of the lending process for both and

banks and prospective loan purchasers, but would extend to "all consumers by increasing the cost of credit and likely cutting some marginal debtors out of the market."[46] Such credit market restrictions threaten greatest harm to the highest-risk borrowers, whose credit needs are frequently unmet by more traditional bank financing.[47]

These risks are illustrated — and magnified — in the context of bank sales to securitization trusts. As discussed above, securitization is a major source of liquidity for consumer lending in the United States. But a securitization trust is not a state or federally-chartered bank; accordingly, if it is deemed to be the "true lender," a trust could buy receivables and sell interests to investors only if *all* of its receivables complied with all potentially applicable state laws, *i.e.*, the laws of the states where all borrowers might reside plus the state where the securitization trust is based. This would be unworkable in practice, effectively forestalling the loan securitization programs that are critical to banks' liquidity needs.

The role of a marketplace lender in marketing and originating loans on a bank's behalf does not alter the preemption analysis.

Proponents of "true lender" tests often allege that the bank in a bank partnership model contracts with a third party to provide marketing, origination, and other services in connection with the loans at issue, but this allegation should not affect the application of preemption. This is a common arrangement in lending programs such as these; marketplace lenders "currently lend to customers across the country through . . . a bank partnership model in which a bank originates the loan, which is generally sourced and serviced by the marketplace lender . . ."[48] Indeed, the FDIC has expressly acknowledged that state-chartered FDIC-insured banks often rely substantially on services provided by third parties for their lending programs — including services provided by third parties that also purchase the loans.[49] As Treasury recognized in its 2018 Report, such lending partnerships "can leverage advantages from both banks and fintechs to improve upon the currently provided products" and expand credit to underserved segments of society.[50]

Proponents of "true lender" tests are fundamentally incorrect in characterizing the banks' role in the loan transactions at issue as too insubstantial to respect their role as lenders. There is nothing insubstantial about entering into a contract that obligates a bank to loan money — and then for the bank to loan the funds to the borrower. Federally insured banks are fully responsible

footnote continued from previous page…

borrowers, and jeopardize the substantial benefits of third-party lending arrangements for borrowers and the economy.").

[46] Kirby M. Smith, *Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales*, 83 U. Chi. L. Rev. 1631, 1682 (Summer 2016).

[47] William F. Baxter, *Section 85 of the Nat'l Bank Act and Consumer Welfare*, 1995 Utah L. Rev. 1009, 1023 (1995); *see also* Karen Gordon Mills & Brayden McCarthy, *The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game* (Harvard Bus. Sch. Working Paper No. 15-004, 2014), *available at* https://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf; Burcu Duygan-Bump, et al., *Fin. Constraints & Unemployment: Evidence from the Great Recession* 1 (Fed. Reserve Bank of Boston Working Paper No. QAU10-6, 2011), *available at* https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/qau1006.pdf.

[48] 2018 Treasury Report, *supra* note 4, at 86-87; *see also* OCC, *Semiannual Risk Perspective* 18 (Spring 2016), *available at* https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2016.pdf.

[49] FDIC, Proposed Examination Guidance for Third-Party Lending (FIL-50-2016, July 29, 2016) (recognizing that in some third-party lending arrangements, the bank "holds the loan for only a short period of time before selling it to the third party," which performs "a significant aspect of the lending process, such as some or all of the following: marketing; borrower solicitation; credit underwriting; loan pricing; loan origination; retail installment sales contract issuance; customer service; consumer disclosures; regulatory compliance; loan servicing; debt collection; and data collection, aggregation, or reporting"), *available at* https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf; FDIC, Supervisory Insights, "Marketplace Lending", Vol. 12, Issue 2 (Winter 2015) (recognizing that in marketplace lending arrangements, a third party "collects borrower applications, assigns the credit grade, and solicits investor interest" and the partner bank "typically holds the loan on its books for 2-3 days before selling it" to the third party), *available at* https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/si_winter2015.pdf.

[50] 2018 Treasury Report, *supra* note 4, at 89, 91-92; *see also* FDIC, Proposed Examination Guidance for Third-Party Lending (FIL-50-2016, July 29, 2016) (recognizing the potential benefits to both borrowers and banks from such arrangements, which may "enable institutions to lower costs of delivering credit products and to achieve strategic or profitability goals"), *available at* https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf.

for all loans they make and are required to ensure compliance with all applicable laws in the marketing and origination of their loans, regardless of the extent to which third parties are involved in the overall loan program.[51] A bank regulated by the FDIC does not avoid any of the standards and requirements that are otherwise applicable to its loans merely by employing a third party for marketing or by selling interests in loan receivables after the loans are made.

Indeed, the FDIC and the OCC (which regulates national banks) have consistently recognized that such service arrangements are fully consistent with a bank's ordinary lending operations.[52] And regulators have watched for potential abuses of such arrangements; both agencies have brought enforcement actions against banks that engaged in lending arrangements that the agencies believed abused their federal lending authority by ceding too much control to third parties.[53] Significantly, however, such enforcement actions have been premised, not on a contention that the banks were not the "true lenders" on the loans, but rather on the contention that the banks, *as lenders*, did not comply with their regulatory obligations in that role.

As the *Sawyer* court recognized, it would be anomalous for the FDIC and OCC to treat loans made pursuant to such lending programs as bank loans for examination purposes under federal law, but for courts to exclude those same loans from the definition of "any loan . . . made" by a state or federally-chartered bank for purposes of the FDIA or NBA. It follows from this "fundamental prudential argument" that "loans serviced through contracts with third parties . . . are included within the definition of 'any loan' under Section 27 of the FDIA and are therefore expressly preempted by the federal statute."[54]

CONCLUSION

Under longstanding federal law that serves as a primary underpinning of today's credit markets nationwide, federal and state-chartered FDIC-insured banks have the authority to make and sell loans without regard to state-law limitations concerning interest rates in states other than the bank's home state. Federal law also specifically contemplates that they will partner with third parties to provide services in connection with their lending programs. "True lender" theories are inconsistent with governing federal law and, if accepted, would chill the market for interstate lending. To put an end to any remaining doubts on this subject, Congress should heed Treasury's recommendation to reconfirm that the existence of a service or economic relationship between a bank and a third party (including fintech companies) does not affect the role of the bank as the true lender of loans it makes.[55] And the OCC and FDIC should issue proposed rulemaking — much like their recent proposed rules reaffirming the valid-when-made rule — confirming these principles. ■

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[51] 12 U.S.C. § 1867(c) (services performed by third parties on a bank's behalf "shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises"); FDIC, Guidance For Managing Third-Party Risk (FIL-44-2008, June 6, 2008) ("the FDIC evaluates activities conducted through third-party relationships as though the activities were performed by the institution itself"), *available at* https://www.fdic.gov/news/news/financial/2008/fil08044a.html.

[52] *See, e.g.*, FDIC, *Credit Card Activities Manual* Ch. XIV (March 2007) (recognizing that in such contexts, "[w]hile the bank sheds itself of a majority of the day-to-day operational duties associated with operating the program . . . , it always retains ultimate responsibility for the program *based on . . . it being the issuer of record*." (emphasis added)), *available at* https://www.fdic.gov/regulations/examinations/credit_card/pdf_version/ch14.pdf.

[53] *See, e.g.*, *In re Goleta Nat'l Bank*, OCC Enforcement Action 2002-93, 2002 WL 31895243, at *9 (Oct. 28, 2002); *see also FDIC Seeks in Excess of $200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing*, FDIC Press Release, June 10, 2008, *available at* https://www.fdic.gov/news/news/press/2008/pr08047.html; *OCC Orders Eagle to Cease Payday Lending Program*, OCC News Release NR 2002-01 (Jan. 3, 2002), *available at* http://www.occ.treas.gov/ftp/release/2002-01.doc.

[54] *Sawyer*, *supra* note 12, at 1368; *see also Discover Bank*, *supra* note 26, at 603 (loan servicer's marketing of loan program was "consistent with its role as a servicing entity" and irrelevant to preemption); *cf. SLMA*, *supra* note 36, at 46 ("Since Congress has permitted a lender to contract out its lending duties to third parties while retaining its status as a lender, it can be inferred that the statute placed an emphasis on form, and that the form is not to be ignored even where the underlying substantive duties are assigned to another party.").

[55] 2018 Treasury Report, *supra* note 4, at 94.