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Bank Partnerships in Marketplace Lending: Recent Developments



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Consumer Finance

MONTHLY BREAKFAST BRIEFING

Agenda



- Bank Partnership Primer
- True Lender and Madden Developments
- OCC “FinTech” Charter Developments
- State Licensing Developments



BANK PARTNERSHIP PRIMER

What is a Bank Partnership?



- Marketplace lending business models vary significantly.
- One family of models involves the origination of loans in partnership between (i) a bank and (ii) a lending platform operating as a service provider to the bank.
- Arrangements may involve a lending platform providing solicitation, application taking and processing, and/or underwriting services to a bank that makes program loans.
- Following origination, the lending platform, an affiliate, or an independent investor may acquire program loans or interests therein.
- Bank may retain account relationship.

Why Do Marketplace Lending Programs Use Bank Partnerships?



- Bank partnerships provide various benefits to lending programs, lending platforms, and the banks themselves.
- Benefits to lending programs and lending platforms:
 - Uniformity
 - Potential applicability of preemption standards under federal banking law that displace state usury limitations
 - More limited application of licensing requirements because less activity is conducted by a non-exempt party
 - Access to bank compliance controls and risk management
 - Access to Visa/Mastercard networks

Why Do Marketplace Lending Programs Use Bank Partnerships?




- Bank partnerships provide various benefits to lending programs, lending platforms, and the banks themselves.
- Benefits to bank:
 - Access to a broader and more diverse borrower base
 - Access to new products for bank customers/clients

What Issues Do Bank Partnerships Raise?



- Partnership and program structure is critical to determining whether loans are validly originated and remain valid through the various transfers involved in marketplace lending.
 - Valid origination = The bank must be the “true lender” in the relationship
 - Maintaining validity through transfers = Programs must address “*Madden*” risk



TRUE LENDER AND *MADDEN* UPDATE

True Lender Cases -- Context



- The “true lender” issue is not unique to marketplace lending. Prior case law has developed in connection with credit card programs and payday lending.
- Courts have applied a range of legal standards.
 - Named Creditor
 - Named Creditor “Plus” (limited additional factors generally tracking standards for determining states from which a bank may export interest under federal banking laws)
 - Predominant Economic Interest
 - Totality of the Circumstances

Madden -- Context



- Class of claims arising from Second Circuit decision in *Madden v. Midland Funding*
 - Facts: A non-bank debt buyer charged interest on a defaulted credit card account at rates permissible at origination only because the original creditor was a bank.
 - Holding: The non-bank could not rely on preemption arguments available to the bank that permitted charging interest in excess of state law limitations.
- Serious questions as to the breadth of the ruling and whether the defendant raised the right arguments regarding its conduct to avoid waiving defenses

True Lender and *Madden* Cases – Recent Developments



- Payday lending cases:
 - *Pennsylvania v. Think Finance*
 - *CFPB v. CashCall*
- Student lending cases:
 - *Beechum v. Navient*
 - *Eul v. Transworld*
- Recent claims against marketplace lending programs:
 - *Bethune v. Lending Club*
 - *Colorado v. Marlette/Avant*

Bethune v. Lending Club




- True lender and *Madden* Complaint
- Lending Club's initial defensive strategy was a Motion to Compel Arbitration
- The Court granted the Motion to Compel Arbitration (on an individual basis) and stayed the case on January 30, 2017.
- Interaction of risk with CFPB's Arbitration Rule

Colorado Litigation



- Cases initially brought by Colorado regulators in state court alleging that rates charged by two marketplace lenders—Marlette (BestEgg) and Avant—were unlawful
- Includes true lender and *Madden* claims:
 - Rates unlawful because the platforms were the true lenders; or
 - Rates unlawful after transfer even if the bank originated loans
- Countersuits filed by banks for each program—Cross River Bank and WebBank—seeking judicial acknowledgement that the banks were the true lender and that transfer of loans did not invalidate interest rates lawful at origination



OCC “FINTECH” CHARTER DEVELOPMENTS

OCC “FinTech” Charter Proposal



- Announced December 2, 2016
- Proposal by OCC to permit non-depositories to obtain special purpose national bank charters
- Possible applicants include not only marketplace lending platforms, but also payment processors, money transmitters, digital currency companies, etc.
- Would provide access to preemption arguments in exchange for (i) supervision by a federal regulator and (ii) satisfaction of capital requirements

FinTech Charter Challenges



- OCC action has been subject to criticism by state regulators and consumer advocates.
- Arguments include that:
 - The National Bank Act does not empower the OCC to charter non-depositories unless they fit into one of three narrow exceptions (credit card banks, trust banks, and bankers banks); and
 - Permitting FinTech companies access to preemption arguments is not sound policy.
- The Conference of State Bank Supervisors (*CSBS v. OCC*) has filed a suit challenging legality of proposed charter.

FinTech Charter Developments



- CSBS v. OCC: Motion to dismiss briefing nearly complete.
- Primary arguments involve legality of charter under National Bank Act and ripeness of action.
- The OCC recently announced that it is not prepared to accept applications for the charter, which may be an operational issue or a strategic approach to support its ripeness argument.
- Practical impact on marketplace lending may be limited, as few platforms appear to be seriously considering an application (and only a few could readily meet capital and other institutional requirements as presently structured).



STATE LICENSING DEVELOPMENTS

State Licensing Background



- Marketplace lending platforms typically engage in several (if not all) of the following activities that may be subject to licensing requirements by states:
 - Marketing and soliciting loans
 - Taking and processing applications, including assisting consumers through the application process
 - Brokering or referring applications to bank partners
 - Acquiring loans from bank partners and holding them thereafter
 - Selling loans to investors
 - Servicing and/or collecting loans

State Licensing Background



- Activities engaged in by marketplace lenders may trigger various licensing requirements, including licenses for:
 - Lenders;
 - Loan servicers and/or debt collectors;
 - Brokers, credit “arrangers,” and/or credit service businesses;
 - Loan solicitation companies and/or lead generators; and/or
 - Loan purchasers/holders.
- Some state licensing laws have anti-evasion provisions, which should be considered, but may be ambiguous in application.

State Licensing Background



- Penalties for failure to obtain a required license may include:
 - Cease and desist orders or other injunctive relief;
 - Civil penalties;
 - Criminal penalties (fines and/or imprisonment);
 - Loan impairment (in whole or in part).
- Failure to obtain a license may result in additional violations, such as violations of usury, fee, disclosure, or other requirements that may not apply (or apply differently) to a licensee.

State Licensing Considerations



- Three layers to consideration when structuring a program:
 - What is clearly subject to licensure (*i.e.*, clear statutory requirements and/or existing guidance)
 - What could a court or regulator expand the license to encompass without a change in statutory law (*i.e.*, flexibility in existing statutory language)
 - What could the legislature expand the license to encompass (*i.e.*, limits imposed by preemption or constitutional restrictions)
- Developments are occurring across all three levels.

Legislation: Vermont HB 182



- Loan solicitation and lead generation license
- Effective May 1, 2017 for licensing provisions
- “Loan Solicitation” includes certain activities conducted “for compensation”
 - Offer, solicit, broker, arrange, place, or find a loan;
 - Engage in any activity intended to assist in obtaining a loan, including lead generation;
 - Arrange a loan through a third party; and/or
 - Advertise or cause to be advertised a loan or the above services.
- Scope excludes residential mortgage loans and retail sellers.

Guidance: Montana Loan Servicing



- Montana Consumer Loan Law
- Licensing requirement applies to:
 - Engaging in the business of making consumer loans; and
 - Contracting for, charging or receiving compensation (interest, fees, etc.).
- Guidance issued February 2016 clarifies that a license is required to service loans, on a first-party or third-party basis.

Litigation: *Maryland v. CashCall*



- Challenge to payday loan program under Maryland Credit Services Businesses Act.
- License required for persons “providing advice or assistance to a consumer” in connection with “obtaining an extension of credit for a consumer” for valuable consideration.
- Holding—“Valuable consideration” prong is met when:
 - Company arranging loan collects a financed origination fee during loan servicing; or
 - Company arranging loans does so without connection to non-lending business and receives compensation from a party other than the consumer.

Litigation: *Ventures Trust*



- Debt collection licensing case involving mortgage loan held in a trust.
- License required to “do[] business as a collection agency.”
- Trust companies exempt—and national bank trustees further shielded by federal preemption under the National Bank Act.
- Holding: Directing a bank trustee to file a foreclosure or other collection suit is licensable activity
- Note: Loans were held in non-bank trust entity that the court determined did not provide trust services

QUESTIONS?



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