

Client Alert

August 2020

Colorado True Lender Litigation Settles: Blazes Trail for Industry

On August 18, 2020, a settlement was reached in two Colorado cases addressing the “true lender” doctrine as it relates to bank-fintech consumer lending relationships.¹

Under the terms of the settlement, a bank is a “true lender” if (i) it engages in certain oversight activities; (ii) the terms of the loan and how it is funded conform to certain requirements; (iii) the fintech entity obtains all necessary licenses; (iv) the bank’s role is disclosed to consumers; and (v) perhaps most significantly, the sale of loans originated by the bank in connection with the fintech relationship meets one of four types of structures.

While the settlement (also referred to as an Assurance of Discontinuance (“AOD”)) is binding only on the named parties and only in Colorado, because it is the first settlement in the “true lender” space and the first settlement since the Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”) issued their pronouncements in the area, all fintech industry participants, including loan purchasers, trustees of trusts, fintech companies, warehouse lenders, banks and credit unions should pay careful attention to the terms of the settlement as all are potentially impacted by the agreement. The settlement also may, as a template, have broad implications for avoiding state usury caps. In that regard, it validates the positions that both Cross River Bank (“CRB”) and WebBank, the platform banks that were parties to the litigation, have taken to date.

The AOD comes on the heels of a number of recent regulatory developments related to the true lender doctrine. This summer, the OCC and FDIC issued their final “*Madden* fix” rules which provided that the assignee of a loan made by a bank can charge the same interest rate that the bank is authorized to charge under federal law. Importantly, the “*Madden* fix” rules did not address the gating question of which entity—the bank or the non-bank partner—is the true lender. Recognizing that gap, on July 20, 2020, the OCC released a proposed “true lender” rule providing that a national bank or federal savings association is the true lender if, as of the date of origination, it is named as the lender in the loan agreement or funds the loan.² Because three states have sued the OCC on its proposed rulemaking, there will be more to come. Nonetheless, the starting point going forward will likely be the detailed and prescriptive AOD.

Safe Harbor Test

The AOD establishes a five-point “safe harbor” test that, if satisfied, protects WebBank’s fintech relationships (including with Avant) and CRB’s fintech relationships (including with Marlette) from Colorado state regulatory enforcement (albeit state oversight remains) by ensuring the bank is treated as the true lender, provided the relationships meet five criteria. By its terms, the AOD (and thus the safe

¹ *Fulford v. Avant of Colorado, LLC, et al.*, Case No. 17CV30377 (Colo. Dist. Ct. Denver County); *Fulford v. Marlette Funding, LLC, et al.*, Case No. 17CV30376 (Colo. Dist. Ct. Denver County).

² Comments on the OCC’s proposed true lender rule are due on September 3, 2020, and it is expected that the FDIC will also issue its own proposed true lender rule in the coming months.

harbor) applies only to the parties to the WebBank and CRB litigation. Nevertheless, bank-fintech relationships operating in Colorado that do not meet all of the criteria risk being found outside of the safe harbor and becoming subject to heightened scrutiny.

As an initial matter, we note that the AOD imposes heightened requirements for what it terms “Specified Loans,” which are a subset of “Loans” originated to Colorado borrowers and bearing interest in excess of the greater of:

- (a) The total of:
 - (I) 36% per year on that part of the unpaid balances of the amount financed that is \$1,000 or less;
 - (II) 21% per year on that part of the unpaid balances of the amount financed that is more than \$1,000 but does not exceed \$3,000; and
 - (III) 15% per year on that part of the unpaid balances of the amount financed that is more than \$3,000; or
- (b) 21% per year on the unpaid balances of the amount financed.

As discussed in more detail below, Specified Loans are subject to, among other heightened requirements, increased limitations on sales from banks to fintechs and/or securitizations.

1. Oversight Criteria

The AOD lists 14 different terms that would need to be satisfied in order for a bank-fintech relationship to meet the Oversight Criteria. The terms generally fall under three main categories: (1) regulatory, (2) credit and marketing, and (3) compliance.

Regulatory oversight. The loans originated by the bank under the program must be subject to oversight by the bank’s prudential regulators, including the FDIC or Federal Reserve and the bank’s state banking regulator (in the case of a state bank) and the OCC (in the case of a national bank), and the same regulators must have access to examine, review and audit the partner fintech.

Credit and marketing oversight. The bank must oversee, control and retain ultimate authority over essentially all aspects of program marketing (including on the partner fintech’s website), loan origination services and credit terms (including credit policies and procedures, loan approvals, policy exceptions and credit models).

Compliance oversight. The bank must approve the partner fintech’s third-party risk management program for significant third-party vendors used in connection with the program. The bank must design its oversight program to follow the compliance requirements for third-party lending relationships found in specified FDIC guidance (FIL-44-2008 and FIL-50-2016). Additionally, the bank must oversee the partner fintech’s compliance management system, including oversight of compliance gaps and related corrective action, and must perform a test, review or audit of the partner fintech’s compliance with applicable laws and regulations at least annually. Finally, the bank and fintech partner must jointly maintain an appropriate complaint management system.

Essentially the parties accept the bank regulators’ 15-year-old position that banks must maintain compliance management systems that extend to, and enable them to police, their customers in exchange for acknowledgment that such a role reinforces that the bank is sufficiently involved to be the true lender.

2. Disclosure and Funding Criteria

The AOD requires that the loan agreement and the fintech’s website and marketing materials must identify the partnering bank as the lender on the loans.

Banks must fund the loans made in connection with the fintech relationship using “any source allowable by banking regulation.” Banks cannot use funds provided by the fintech for the express purpose of funding the origination of loans.

3. Licensing Criteria

Under the AOD, the fintech must obtain a license in the following scenario:

if the [fintech] takes assignment of and undertakes direct collection of payments from or enforcement of rights against consumers arising from [“supervised loans” in Colorado as defined by Colo. Rev. Stat. § 5-1-301(47)]³, the [fintech] shall obtain a license from the Administrator pursuant to the UCCC, C.R.S. § 5-2-301.

The AOD also imposes various reporting requirements on fintechs licensed in accordance with the foregoing requirement.

It is important to note that the AOD is silent on licensing requirements with respect to both the trustees of the statutory and common law trusts that purchased loans from Avant and Marlette and the banks that were named as defendants in the litigation.

4. Consumer Terms Criteria

Specified Loans must not have an APR in excess of 36%. However, if Marlette, CRB, Avant and/or WebBank settle similar claims with another state and the terms of that settlement provide a lower APR cap, the lower APR cap reached in that agreement will apply to this agreement for the party settling with the other state.

The 36% (or in some cases, like the FDIC’s small loan study, 35%) interest rate cap has a long history in the consumer lending industry and, indeed, is already used for fintech industry trade groups and associations as a prerequisite for membership. As such, it may not represent much of a departure for many fintechs but draws a line in the sand between them and payday lenders. Capping the APR at 36% ensures these ventures can continue to extend responsible access to affordable credit for Colorado borrowers.

All loan agreements for Specified Loans must provide that Colorado law applies, except where preempted by federal law.

5. Structural Criteria

In order to qualify for the AOD’s “safe harbor,” the sale of loans originated as part of the fintech relationship must comply with at least one of four transactional structures, called “Structural Criteria” in the AOD: (i) Uncommitted Forward Flow Option; (ii) Maximum Committed Forward Flow Option; (iii) Maximum Overall Transfer Option; or (iv) Alternative Structure Option.

The four options, in connection with the other “criteria” set forth by the AOD, allow transactions to fall under the “safe harbor” provided by the AOD. As stated earlier, they are not the only options available and parties may decide to structure transactions differently, albeit without the “safe harbor.”

³ “Supervised loan” means a consumer loan, including a loan made pursuant to a revolving credit account, in which the rate of the finance charge exceeds twelve percent per year as determined according to the provisions on finance charges contained in section 5-2-201. Colo. Rev. Stat. § 5-1-301(47). The finance charge limits are those outlined in connection with the “Specified Loans” definition.

The Uncommitted Forward Flow Option and the Maximum Committed Forward Flow Option only apply to Specified Loans.

Option 1: Uncommitted Forward Flow Option

The main points of the Uncommitted Forward Flow Option are:

- Cannot be a committed obligation, in advance, to purchase any Specified Loan from a bank.
- Notwithstanding the foregoing, a bank and fintech can structure a “process for the sale of Specified Loans as follows”:
 - Bank notifies fintech of the Specified Loans it wishes to offer for sale;
 - Fintech provides notice of the offered Specified Loans it wishes to purchase;
 - If fintech does not purchase Specified Loans offered by bank, bank can:
 - Retain the Specified Loans and service them;
 - Sell the Specified Loans to a third party (not an affiliate of the fintech);
 - Contribute the Specified Loans into a securitization sponsored by the fintech or affiliate of the fintech but participation terms must be similar to other investors contributing Specified Loans into the securitization; or
 - Contribute the Specified Loans into a securitization sponsored by an unrelated third party.
 - Bank may choose at any time to stop originating new Specified Loans and does not have to retain any Specified Loans.
- Bank can seek indemnification only for losses incurred that relate to the following:
 - Services that fintech agrees to perform;
 - Fraud on the part of the fintech or borrowers; and
 - Representations and warranties that the fintech makes.
- Bank cannot seek indemnification for losses incurred that relate to the following:
 - Fintech’s failure to purchase Specified Loans (unless fintech has agreed to purchase Specified Loans in a manner that complies with the Uncommitted Forward Flow Option outlined above); or
 - Performance of Specified Loans (but may seek indemnification for losses if borrower’s non-payment is related to fintech’s failure to perform services as agreed).
- Fintech may contract for indemnification from its vendors so long as a vendor does not provide indemnification on a basis prohibited by the foregoing limitations.
- Bank can require fintech to maintain cash collateral to secured fintech’s obligations for the entire program, not just the Specified Loans, but:
 - Collateral cannot, with limited exception, be used to secure payment by the fintech to purchase Specified Loans from the bank.

Option 2: Maximum Committed Forward Flow Option

The main points of the Maximum Committed Forward Flow Option are:

- Must comply with one of two structuring mechanisms:
 - Bank does not transfer to fintech or its affiliates “Economic Interests in Specified Loans” that exceed 49% of the total origination volume of Specified Loans in the program with the fintech during any calendar year.
 - Under this option, bank MAY NOT transfer to fintech or any of its affiliates any additional Economic Interests in Specified Loans on an *uncommitted* basis.

- Bank does not transfer to fintech or its affiliates “Economic Interests in Specified Loans” that exceed 25% of the total origination volume of Specified Loans in the program with the fintech during any calendar year.
 - Under this option, bank MAY transfer to fintech or any of its affiliates any additional Economic Interests in Specified Loans on an *uncommitted* basis.
- There are no limits on collateral or indemnification for *committed* agreements but any *uncommitted* agreements must satisfy the Uncommitted Forward Flow Option above in order to qualify for the “safe harbor.”
- There are no limits on banks transferring Specified Loans or Economic Interests in Specified Loans to independent third parties.
- Banks may at any time contribute Specified Loans into a “*bona fide*” securitization transaction, including one sponsored by the fintech or its affiliates, provided that the bank participates on terms similar to other investors contributing Specified Loans into the securitization.

Option 3: Maximum Overall Transfer Option

The material points of the Maximum Overall Transfer Option are as follows:

- Bank can transfer to the fintech or its affiliates not more than 85% of all loans (including Specified Loans) under the bank-fintech relationship on an annual basis but:
 - Not more than 35% of the total originated principal amount of all loans originated under the relationship on an annual basis shall be Specified Loans; and
 - The selection of loans for sale to the fintech or its affiliates may not result in the fintech or its affiliates purchasing a pool that consists of more than 35% Specified Loans or 35% Economic Interests in Specified Loans on an annual basis.
- There are no limits on collateral or indemnification for *committed* agreements but any *uncommitted* agreements must satisfy the Uncommitted Forward Flow Option above in order to qualify for the “safe harbor.”
- There are no limits on banks transferring Specified Loans or Economic Interests in Specified Loans to independent third parties.
- Banks may at any time contribute Specified Loans into a “*bona fide*” securitization transaction, including one sponsored by the fintech or its affiliates, provided that the bank participates on terms similar to other investors contributing Specified Loans into the securitization. We expect that the economics of such arrangements will spur securitizations of such loan originations.

Option 4: Alternative Structure Option

In order to qualify under the Alternative Structure Option “safe harbor,” the transaction must be approved by the Colorado Administrator in writing.

Obligations to Comply with the AOD

WebBank and Avant agree that, with respect to the WebBank/Avant program, and CRB and Marlette agree that, with respect to the CRB/Marlette program, they will revise the program terms to comply with the AOD and its “safe harbor” for a period of at least 5 years. However, the banks and/or fintechs can terminate the compliance requirement with 30 days’ notice to the Administrator if, after 2 years from the date of execution of the AOD, there has been a “change in law.”

“Change in law” is defined to mean: (i) a federal or Colorado statute enacted after the AOD is executed; (ii) a decision of the US Supreme Court, Colorado Supreme Court or Colorado appellate court (provided cert has not been sought within the time permitted or was denied); or (iii) a regulation finalized by the FDIC that adopts a test for determining whether the bank in an arrangement with a fintech is the “true lender.” The AOD states that “changes in law” that address permissibility of charging a contract rate of

interest after assignment (colloquially addressing “valid when made” issues) do not count as “changes in law” to excuse performance. Additionally, the AOD states that any FDIC rule on “true lender” is not a “change in law” that excuses performance unless one year has passed from publication of the rule and the rule has not been (i) rescinded by Congress; (ii) rescinded, terminated or withdrawn by the FDIC; (iii) superseded by federal statute; or (iv) enjoined by a court.

Conclusion

Previous litigation regarding “true lender” issues involved Native American Tribes and other structuring mechanisms long discouraged by most bank-fintech relationship participants and groups. As such, the AOD represents the first time a regulator and fintechs/banks have established a framework for what it means for the bank to be the true lender in relationship with a fintech in the context of a contemporary structure. While limited to the parties in the dispute and to Colorado law, given its status as the “first” to discuss the modern fintech industry, the AOD establishes important precedent for other bank-fintech relationships to consider in other jurisdictions. As indicated above, the AOD does not foreclose other forms of relationships but does provide a guide post for such transactions.

In that regard, the settlement is an excellent compromise. It represents a vindication of the platform banks that they were the true lenders. Colorado regulators were able to document the assertions of the banks as to how they managed a compliant program. The parties mutually confirmed what level of bank involvement is needed. Because most platform banks, presumably including CRB and WebBank, already seek to comply with the FDIC FILs, acceding to such terms is more documentation of what they are already doing than changing their approach.

We conclude by noting that many of the safe harbor criteria terms must be documented by contract. Accordingly, we strongly suggest that banks, fintech partners and other involved parties engage experienced legal counsel when structuring their relationships to ensure that all requirements are satisfied.

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