The Consumer Finance Podcast x _Payments Pros_ Podcast – Point-of-Sale Finance Series: Banking on Lending Models
Host: Chris Willis
Guests: Jason Cover and Taylor Gess
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Chris Willis:

Welcome to this special joint episode of *Payments Pros* and *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper Locke's Consumer Financial Services Regulatory Practice. And today's episode is the next installment in our special highlight series on point-of-sale finance, where we're going to be talking about licensed lending versus bank model lending programs with Jason Cover and Taylor Gess, just like our last episode.

But before we jump into that topic, let me remind you to visit and subscribe to our blogs, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget about all of our other podcasts. We have the *FCRA Focus*, the *Crypto Exchange*, *Unauthorized Access*, which is our privacy and data security podcast, and our auto finance podcast called *Moving the Metal*. All of those are available on all popular podcast platforms.

And speaking of those platforms, if you like this podcast, let us know. Leave us a review on your podcast platform of choice and tell us how we're doing. Now, I'm happy to welcome back Taylor and Jason to this second installment in our point-of-sale collection that we're putting out on *Payments Pros* and *The Consumer Finance Podcast*. And this time we're going to be talking about licensed lending versus bank model lending programs. That is, do you have a non-bank who's going to be obtaining a state license and lending on its own, versus one that may be partnering with a bank to be the lender or the creditor in connection with the transaction?

So, Taylor and Jason, welcome to the podcast again. Thanks for being here.

Jason Cover:

Thanks for having us again, Chris.

Taylor Gess:

Thanks, Chris.

Chris Willis:

Taylor, let me start with you. Can you start to explain to the audience the important differences between sort of a direct licensed lending model versus a bank model program? Both of them are very popular in the marketplace.

Taylor Gess:

Sure, Chris. In a direct lending program, this is where we're going to have a non-bank entity that is dispersing funds directly to a consumer on behalf of the consumer after obtaining lots of state licenses, state registrations under these licensed lender laws. And those licenses are going to be triggered based on various loan amount and interest rate triggers in the state law. And that non-bank entity will act as the creditor originating the loans, the solicitor advertising the loans, and generally servicing the loans itself as well. Versus in a bank program, we have facilitators that are usually fintechs, that are partnering with, typically, a state-chartered bank, but it could also be a national bank to operate a lending program. I think Jason was going to talk a little bit more.

Jason Cover:

We should say the direct lending program could just be a bank operating on its own, too, right? That's just generally the concept of the lender, for the most part, sort of fulfills all the, what I call, facilitation roles itself. For bank programs, it's something multi-advantageous, usually between a fintech facilitator for the most part and usually a state-chartered bank. But they kind of help fulfill gaps that one may or may not have, particularly from the financial technology side. The fintech is usually providing that function to the bank that just maybe doesn't have those resources. It's really been a boon for state-chartered banks, and I feel like that's kind of been lost in the conversation over the years.

But typically, the facilitators assist with marketing or solicitation activities, any servicing collections activities, and then they may also participate economically in the loans that are originated by the banks. That could be a participation interest of some sort, taking assignment of whole loans, taking assignment of loan receivables, different ways to do that. And it could be one or more of those types of activities. But on the whole, it is a symbiotic relationship and a mutually beneficial relationship between both the bank and the fintech or facilitator.

Chris Willis:

Well, let's pause for a second, Jason, and talk about that latter point, because so much of the dialogue around bank-fintech partnerships pretends as though it's all about the fintechs, and the banks are really just sort of the tail on the dog. But you made a comment that these are very beneficial programs to banks, too. Do you mind elaborating on that for a moment?

Jason Cover:

Absolutely, Chris. I mean, I think it is lost on a lot of, certainly, the consumer advocacy groups, that there's just a lot of small banks out there. And they could be community banks, right? They could be all kinds of different banks. And most of these banks just don't have the resources to implement even something like an app, right? Something that many of us feel is part of our general banking experience. But if you don't have a tech department or the resources to work with third parties that do, you may not be able to implement an online banking platform, which seems borderline preposterous in the modern world. So, I truly believe that this is something that is beneficial on the whole. It's unfortunate that so much of the conversation has been about the fintechs and with less focus on what these programs do for the banks themselves.

Chris Willis:

Yeah, of course. I think you're right about that because this is something that can have a lot of benefits to a bank in terms of introducing their brand name to a lot of new customers. Not to mention just the benefits that they get from being the creditor in the program by itself, but it helps them build their reputation, build their brand name, et cetera, using distribution channels that otherwise wouldn't be available to them because, as you said, they don't have the technology to advertise and partner on that sort of a scale.

Jason Cover:

Which is also beneficial to consumers because it just makes consumer financial products available to a wider audience that may not be able to get banking services from the large institutional bank down the street.

Chris Willis:

Taylor, let's turn to the thing that has sort of occupied the attention of a lot of commentators on this issue, and that is, what are the fintechs getting out of the partnership with the bank? Because I think this is going to be the place where we figure out why it's gotten so much attention from consumer advocates and regulators. So, what do the fintechs get out of it, Taylor?

Taylor Gess:

Earlier, we were talking about how there are lots of state laws when you're doing a lending program. That means that there could be 51 different jurisdictions with different rules and requirements. And I think sometimes fintechs are hoping to have more uniformity across whatever loan program they're facilitating. And so, because federal law authorizes banks to export their home state rated authority into the other states, these bank partnerships allow the bank and fintech to offer a nationwide program without the same extent of state-specific tailoring that the licensed lending laws under a direct model would require. And we do have fewer licensing implications and fewer examination requirements when we're partnering with a bank and a bank model program.

Jason Cover:

Just to bolster Taylor's point, Chris, most of our clients that operate license and lending programs do so as if they had, for however many states they operate in, different products. That would mean completely different roles for each product in each state, potentially different agreements for each product in each state, even though maybe their sole product is really just an installment loan or a line of credit. It is, nothing against states governing what they do, but it can be a very daunting and costly experience for direct lenders.

Chris Willis:

Yeah, absolutely. And Taylor, you mentioned sort of the idea of interest rate exportation, which is something that banks have under the National Bank Act and under the Federal Deposit Insurance Act. Does that mean if a non-bank partners with the bank to offer a credit product, then that means the program can charge any interest rate at once and there's just no overhang from state regulation at all?

Taylor Gess:

Well, it doesn't always get as quite that far, Chris. We've recently seen an uptick in “true lender enforcement,” and litigation, and states enacting true lender statutes. In a bank program, we see regulators and plaintiffs take the position that the fintech partner is "the true lender" and that the bank originating the loan is being used for that interest rate exportation authority. But behind the scenes, the fintech is controlling the program in a way that would make it be deemed a true lender.

And so, we've recently seen an influx of state licensed lender statutes codifying "true lender" type principles and concepts, such as a predominant economic interest test or a totality of the circumstances test to kind of provide a framework for determining who that "true lender" is on the transaction. Those true lender developments are definitely something that a fintech needs to consider when it's structuring a bank partnership.

Jason Cover:

And Taylor, there's been tons of recent activity. But on some level, these concepts have been around for a long time, right? Attorney General Spitzer in New York launched enforcement 20 years ago or over 20 years ago, and there's really bad case law in New York because of it. There's been some of these true lender statutes around for quite some time. And they sat largely dormant with states on adopting them again for 20 years or so. And then a couple years ago, Illinois, almost in the middle of the night, adopted the Predatory Law and Prevention Act, which sort of set off the modern resurgence, I think, of states rushing to adopt these types of rules and I think largely in response to the influx of fintech lenders in the space.

Chris Willis:

But beyond the whole true lender thing, Jason, there have been other sort of state attacks on these kinds of programs, not based on recharacterizing the non-bank as the true lender, but through other mechanisms as well. I think it's important for the audience to hear about those.

Jason Cover:

Yeah, I think that maybe the most controversial at the moment is the purported opt-out from the Depository Deregulation and Monetary Control Act of 1980. I got it all out in one piece. We usually say "DIDMCA." I know people have other abbreviations or monikers for it. But this is essentially an opt-out from the state-chartered banks' preemption rights under federal law. Colorado recently did this. And that would mean that any state-chartered bank, at least if you take Colorado's viewpoint and a few other handful of states, they would argue that that bank has to comply with Colorado usury. Regardless of whether you partner with a fintech or not, they want to take the position that that state bank can only charge that amount.

I think we've seen a little bit of a recent influx of states arguing that if a fintech needs a license, they can't necessarily capture the rate or facilitate loans with rates above their usury limits. And then this is somewhat dead, but the Madden/valid–when made arguments have also been made that once a loan is assigned, the assignee no longer has the rate authority of the bank versus valid with when made meaning, once it's made by the bank, you should be able to take whatever rate authority the bank had upon assignment.

Chris Willis:

Right. So, the states are definitely not just sort of lying down and taking bank partnerships at face value, as you and Taylor have just mentioned. That's a significant issue for people to consider in these programs. But what are some of the other common pitfalls or things that both the bank and the fintech should take into account when setting these programs up? Because there's actually a lot to be considered with respect to these.

Jason Cover:

I agree, Chris. And just to reiterate, first and foremost, I think if you're going to do a bank partnership, you need to do your homework about what the state's applicable position is on whether it's true lender, or rate authority, et cetera. It's unfortunately turning into as much of a hodgepodge as some of the licensed lending laws. That's an immediate sort of landmine there.

Another thing that I think some clients don't think about is that it can be more expensive than a licensed lending program. Licensed lending programs or RIC programs, since we're talking about point-of-sale finance here, they have their own costs. But it's not free to work with a bank. So, you need to sort of build that into your metrics.

I think a lot of clients have thought, "Oh, I just do this bank program. Then I don’t have to worry about licensing at all anymore." But that's not true either. Those kind of touch points we talked about for facilitation, whether it's marketing the loan, soliciting the loan, servicing or taking collections on the loan, or even taking assignment or participating in the loan, those may trigger licensing requirements under applicable law. And I think regulators are increasingly familiar with fintech bank programs, and thus more likely to know when folks are operating them and requiring the licenses.

I think one of the big advantages for a licensed lending program potentially, particularly if you're operating like under a usury rate instead of a licensed rate, is you can start up tomorrow once you have the agreement or once you have your license. Whereas working with a bank may take a really long time, like six months to a year to sort of get approval, get all of the licenses, work on a 50-state basis, and have the bank onboard and approve your process.

I want to note here, all the banks we work with, they carefully monitor their programs. This is not the argument that the advocacy groups make where the banks are just completely inactive. I don't know if that ever existed. It certainly doesn't exist anymore. These banks are savvy and typically have compliance departments or outside counsel. They carefully review the program agreements and the consumer-facing agreements.

Another potential thing to consider is that a lot of banks, again, they're monitoring the folks they work with, they often want to see a proven track record. If you're a complete startup, they may want to see that you can operate a licensed lending, or a general usury program, or a RIC program, just to sort of show that you know what you're doing and that you have all of your compliance obligations in check.

And then a lot of clients think, "Oh, if I do this bank program, I don't have to worry about any laws, right?" But the thing that you largely don't have to worry about is interest rates because of the federal preemption. But particularly for a state-chartered bank, there's plenty of state laws that still apply, and many of them in the consumer credit codes. For those of you that are all familiar with "Uniform Consumer Credit Codes," any state that has adopted that doesn't necessarily exclude banks from their purview. There's disclosure or other substantive obligations that may still apply, and you need to at least do a little bit of homework there as well. And finally, while we may avoid some state-level obligations and examination, keep in mind there are federal regulators too. OCC, FDIC, or others may be actively examining the bank that you work with.

Chris Willis:

Yeah, and I think that last point, Jason, is one that I'd like to particularly underline because a fintech or a non-bank that wants to do a program with a bank has to deal with the fact that, as you noted, the banks are very scrupulous about reviewing, and vetting and monitoring on an ongoing basis, these programs. And they do that not only for their own reasons, but also to satisfy the demands of their regulators, whether it's the FDIC or the OCC. And this was an area where we saw those federal banking regulators putting a lot of expectations on the banks in bank/non-bank partnerships over the course of the last four years. And I personally don't think that level of scrutiny is likely to change very much, which means I think the banks' requirements and expectations are not likely to change much, despite the fact that we've had an administration change in Washington.

I think from the standpoint of fintechs or other non-banks that wish to do these partnerships, they've got to be ready to do sort of bank-level compliance, monitoring, and reporting if they hope to keep their bank satisfied and their bank's regulator satisfied for exactly the reasons, Jason, that you just mentioned. That's my observation about this, at least.

Jason Cover:

I 100 % agree. At least as of the date when recording this podcast, I think what we've observed is that business is generally as usual at the OCC and the FDIC. Maybe that will change in the future, but we just haven't seen the shift that we have at the CFPB to date. And then I just want to remind everyone that we're, I don't know, three-and-a-half years-ish in here. You're on the hook for anything that happened in the next three-and-a-half years if there is an administration change. I don't know that the current state of things means that you get the get-out-of-jail card forever, right? I think our banks tend to take conservative decisions in that regard and are going to want to make sure that they pass an FDIC exam if it occurs in three-and-a-half years instead of six months from now, too.

Chris Willis:

Yep. Well, I think the other factor, too, is that there have been some high-profile failures in bank/non-bank partnerships, really more in the sort of deposit space than perhaps in the lending space. But those are all recent enough in everybody's mind that the regulators don't want to contribute to another one of those failures, and the banks don't want to be involved in one of those failures because it was a big, big mess for everybody involved when it happened a year or so ago. And I think that will probably keep the regulators, like the OCC and the FDIC, from relaxing their expectations about third-party oversight from what we've experienced over the past several years. That's at least my belief.

Jason Cover:

I absolutely agree with that.

Chris Willis:

Jason, Taylor, I think we've done a good job of telling the audience about the important things to keep in mind between direct licensed lending programs and those where a bank partners with a non-bank to deliver a product. Thank you both for joining me again for this discussion. And, of course, we're going to be continuing this special highlight series in the near future with some more about sales finance. But in the meantime, thanks to our audience for listening. And don't forget to visit and subscribe to our blogs, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And while you're at it, why not visit us on the web at troutman.com and add yourself to our Consumer Financial Services email list. That way, we can send you copies of the alerts and advisories that we send out, as well as invitations to our industry-only webinars that we put on from time to time. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.