

MARKETPLACE LENDING BANK PARTNER AS TRUE LENDER

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In our last *FinTech Flash* we covered the pros and cons of marketplace lending platform companies entering into bank partnerships. If the arrangement is structured properly, two significant advantages result:

- The platform company does not need state lender licenses.
- By virtue of the bank partner enjoying interest rate exportation authority, interest may be charged uniformly nationwide on program loans at rates that may not be permitted for non-bank lenders.

Establishing a bank partnership requires careful analysis and expertise. Certainly, the bank is identified as the lender on the note or loan agreement and, therefore, is the lender by contract with the borrower. Approvals, disclosures and other significant loan-related materials should identify the bank as the lender as well. Because the bank must also be the lender in fact, it is important to go beyond the loan documents and ensure the bank maintains the level of activity, authority over the loan program and economic interest in the loans that one reasonably would expect of a lender.

If a court or regulator concludes that the platform company is the true lender, the consequences can be serious. The company can come under scrutiny for operating without a lender license, making usurious loans, or acting in an unfair or deceptive manner. Penalties could include a cease and desist order until a license is obtained, disgorgement of the interest differential between what the bank assessed and what the platform company could have charged in its own right, loans becoming void or uncollectible, and other fines or civil damages.

Not all authorities view the "true lender" issue the same.

However, regulator opinion letters, enforcement actions and case law in various jurisdictions have provided the industry guidance on best approaches to follow in structuring bank partnerships. Three general lines of true lender inquiry have emerged from these authorities, asking:

- Does the bank perform or control the non-ministerial activities normally performed by a lender?¹
- Is the bank the real source of funding?²
- Does the bank have an economic interest in the loans and origination-related risk?³

These questions lead to a number of specific factors to consider in forming a bank partnership to ensure that the bank is the true lender. Below is a partial list of examples of these factors. *A complete true lender analysis is based on the totality of the facts and circumstances and will take into account other factors unique to each arrangement.* If the bank is the true lender, a number of the factors below will be present.

(A future *FinTech Flash* will cover marketplace lending-related regulatory, enforcement and litigation actions, including last week's California federal district court decision in *Consumer Financial Protection Bureau v. CashCall, Inc.*, adopting the "predominant economic interest" test for determining the true lender in a tribal lending model.⁴)

TRUE LENDER FACTOR EXAMPLES

Non-Ministerial Activities

- The bank partner controls the underwriting guidelines and approves any material changes.

- Discretionary exceptions from the underwriting guidelines are approved by the bank partner on a loan-level basis.
- The bank partner determines the loan features, terms and conditions, and approves any material changes.
- The bank partner controls loan fee, rate and pricing guidelines and approves any material changes.
- Marketing materials are approved by the bank partner. The bank partner is identified as the lender in marketing materials.

Real Source of Funding

- The bank partner funds the loans with its own money on its own balance sheet.
- The purchase price for a loan purchased from the bank partner by the FinTech platform company is not paid before legal title to the loan is transferred.

Economic Interest and Risk

- The bank partner holds some loans in its own portfolio.
- The bank partner holds the loans it sells to others (including the FinTech platform company) for a period of time before sale.⁵
- The purchase price paid by the FinTech platform company reasonably relates to the market value of the loan.
- As part of the purchase price, the bank partner is paid for accrued interest during the holding period.
- The entire monetary burden and risk of the program is not placed on the FinTech platform company.
- The bank partner bears origination-related risk reflected in representations, warranties or covenants in the loan sale agreement with buyers (including the FinTech platform company).

It should be underscored that true lender analyses vary by regulator and jurisdiction and are fact-specific. Authorities will consider additional factors, giving more or less weight to each based on the facts and circumstances of the arrangement and legal precedent.

ABOUT GOODWIN'S FINTECH PRACTICE

Goodwin's FinTech Practice is backed by a cross-disciplinary team of approximately 70 attorneys with expertise in financial services, private equity, technology, investigations, intellectual property, consumer financial services, business and securities litigation. Having represented more than a quarter of the companies on the current *Forbes FinTech 50* list and ranked as one of the top 5 most active law firms advising on FinTech industry deals according to *PitchBook* and SNL rankings, Goodwin is a recognized market leader in the FinTech sector and serves an extensive client base on corporate, regulatory, litigation and enforcement matters.

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End Notes

¹ See, e.g., FDIC General Counsel's Opinion 11, 63 Fed. Reg. 27282 (May 18, 1998).

² See, e.g., 12 C.F.R. § 1024.5(7).

³ See, e.g., Ga. Code Ann. § 16-17-6; *Kyle Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359 (D. Utah May 23, 2014); *CashCall, Inc. v. Morrisey*, No. 12-1274, 2013 W. Va. LEXIS 587 (W. Va. May 30, 2014).

⁴ *Consumer Financial Protection Bureau v. CashCall, Inc.*, CV 15-7522-JFW (RAOx) (C.D. Cal. Aug. 31, 2016) (Applying the "predominant economic interest" test, and emphasizing the "key and most determinative" true lender factor is whether the lender "placed its own money at risk at any time during the transactions, or whether the entire monetary burden and risk of the loan program was borne by [the other party in the arrangement].")

⁵ The facts and circumstances of each factor will affect the analysis. The length of the hold period in this factor is an example. There is not, however, much legal guidance on the sufficient length of the hold period.

