Special Alert: Maryland Ruling Opens New Front in Battle Over Bank Partnership Model

On June 23, the Maryland Court of Appeals affirmed a lower court judgment holding that a non-bank entity assisting consumers obtain loans from an out-of-state bank and then repurchasing those loans days later qualifies as a "credit service business" under the Maryland Credit Services Business Act (MCSBA), requiring a state license among other obligations. *CashCall v. Md. Com'r of Financial Reg.*, No. 24-C-12-007787, 2016 WL 3443971 (Md. Ct. App. June 23, 2016). This holding is of particular importance to marketplace lending platforms that rely on bank partnerships to originate consumer loans because, in addition to requiring a license, the MCSBA prohibits licensees from arranging loans for out-of-state banks above Maryland's usury ceiling.[1]

In light of the ruling, the MCSBA could provide a roadmap for other states to test the limits of federal law, which specifically authorizes banks to export interest rates permitted by their home state notwithstanding another state's usury limitations. Perhaps in view of a potential future challenge on federal preemption grounds, the *CashCall* Court appears to have gone out of its way to state in *dictum* that the non-bank entity was the "*de facto* lender" based on its efforts to market, facilitate, and ultimately acquire the loans it arranged. In so doing, the Court provides a strong suggestion that it might have reached the same result relative to the state's usury laws under the "true lender" theory that has gained some traction in other actions against non-bank entities.[2]

While the most immediate impact of the Court's ruling is to uphold the state financial regulator's cease and desist order and $5.65 million civil penalty, the case also creates additional risk and uncertainty for marketplace lending platforms and other FinTech companies seeking to maintain a regulatory safe harbor through the bank partner model. We analyze here the import of this latest case as part of the appreciable tension building as state law theories appear to be increasingly penetrating chinks in the armor of federal preemption principles.

Key Facts, Issue, and Holding

The non-bank company in this case (the "Company") partnered with a federally insured state bank to originate loans in all US jurisdictions, thereby seeking to leverage federal preemption to overcome state licensure requirements and usury limitations. In that vein, the Company advertised the bank's loans to Maryland consumers, submitted completed loan applications for approval, administered the execution of loan documentation in the bank's name, and thereafter purchased the loans from the bank three days after origination and serviced the loans for the duration of the loan term.

The Maryland financial regulator determined that the Company's conduct met the definition of a credit service business under the MCSBA and brought an enforcement action in 2009 against the Company for operating without a license in violation of the MCSBA.[3] On appeal, the Company asserted that it was not

[1] "A credit services business, its employees, and independent contractors who sell or attempt to sell the services of a credit services business shall not . . .assist a consumer to obtain an extension of credit at a rate of interest which, except for federal preemption of State law, would be prohibited under Title 12 of this article." Md. Code Ann., Com. Law § 14-1902(9).

[2] *See, e.g., CashCall v. Morrisey*, 2014 WL 2404300 (W. Va. 2014). Note also that West Virginia cases have also held that non-bank entities that refer loans to banks must register with the West Virginia Secretary of State as providers of "credit services" pursuant to the state's Credit Services Organization Act, W. Va. Code § 46A-6C-1 *et seq*. *See, e.g., Harper v. Jackson Hewitt, Inc.*, 706 S.E.2d 63, (W.Va. 2010) (holding that a tax preparer who receives compensation, either directly from the borrower or in the form of payments from the lending bank, for helping a borrower obtain a refund anticipation loan meets the statutory definition of a credit services organization under W. Va.Code § 46A–6C–2(a)).

[3] "A credit services business, its employees, and independent contractors who sell or attempt to sell the services of a credit services business shall not . . .receive any money or other valuable consideration from the consumer, unless the credit services business has

a "credit service business" within the meaning of the MCSBA, because it did not receive a direct payment from the consumer, a prerequisite based on prior case law to fall within the statute's scope.[4] But the Court disagreed with the Company, determining, as the lower court had, that direct payment from the consumer is not a requirement to be deemed a credit service business under the MCSBA. In so holding, the Court also limited and clarified its earlier decision in *Gomez v. Jackson Hewitt, Inc.*, 427 Md. 128, 46 A.3d 443 (2012)[5] that had required a direct payment by a consumer to trigger coverage of the MCSBA: "[T]his Court's decision in *Gomez* was not intended 'to apply beyond the factual boundaries of that case, and certainly it was not intended to extend to companies. . .whose sole purpose is to arrange loans for Maryland consumers and thereby exclude the very businesses that the MCSBA was intended to cover."[6]

True Lender Dicta

The Court also cited to the lower court opinion to suggest that the Company was the *de facto* lender in view of the fact that "[i]n exchange for [its] role in assisting consumers to obtain the aforementioned loans, [the Company] received, through contracts with the banks, the exclusive right to collect all payments of principal, interest and fees, including the origination fee. . . . Although the lending bank originally charged the origination fee, '[t]he bank never received payment of that fee from the consumer but, as noted, [the Company] did."

Although the "true lender" analysis was not germane to the narrow question of whether the Company was subject to MCSBA, the insinuation of a straw transaction provides further context for the Court's decision and perhaps foreshadows separate obstacles for the bank-partner model in Maryland. The Court tacitly aligned itself with a line of preemption cases that take a very narrow view of the protection afforded to non-bank entities through their affiliation with such bank partners,[7] and accepted without discussion the MCSBA's prohibition of credit services businesses arranging loans for out-of-state banks at rates that exceed the state's usury laws.[8]

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secured from the Commissioner a license under Title 11, Subtitle 3 of the Financial Institutions Article." Md. Code Ann., Com. Law § 14-1902(1).

[4] "Credit services business" means any person who, with respect to the extension of credit by others, sells, provides, or performs, or represents that such person can or will sell, provide, or perform, any of the following services *in return for the payment of money or other valuable consideration*: (i) Improving a consumer's credit record, history, or rating or establishing a new credit file or record; (ii) Obtaining an extension of credit for a consumer; or (iii) Providing advice or assistance to a consumer with regard to either subparagraph (i) or (ii) of this paragraph. Md. Code Ann., Com. Law § 14-1901(e)(1) (*emphasis added*).

[5] The Court's opinion in *Gomez* undertook an exhaustive review of the MCSBA's legislative history to determine that a tax preparation service provider, whose primary services were ancillary to its loan referral business, was not a credit service business, in part because the payment it received for referring potential borrowers came from the bank, not the consumer.

[6] The Court's assessment of Maryland law may be inconsistent with certain aspects of the applicable statute's legislative history, which the *Gomez* opinion considered in substantial depth. In particular, *Gomez* quoted the Commissioner's written testimony in support of the 2001 passage of the law:

> While the law] does not and cannot interfere with the federally insured lender's ability to directly make those loans in Maryland, it does not prohibit local agents from facilitating the transactions. *Under the [CSBA], if a lender compensates a third-party to assist Maryland consumers obtain credit, the agents are subject to the Act. The Act does not prevent the exportation of interest rates or the making of high-cost payday loans, but it does subject the third party agents to the licensing, disclosure and other provisions of the Act.*" (*emphasis in original*).

46 A.3d at 465.

[7] *See, e.g., Green v. H & R Block, Inc.*, 981 F.Supp. 951, 955 (D. Md. 1997) (stating, in pertinent part, "[t]here is no support for the proposition that an entity that acts in concert with, or is in privity with, a national bank is entitled to remove state claims to federal court under the [National Bank Act]."); *see also Madden v. Midland Funding LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. den'd*, 2016 WL 3461580 (2016) (holding that a non-bank did not receive the benefit of federal preemption as the purchaser in a debt sale where a national bank originated the underlying credit); *see also CashCall v. Morrisey*, 2014 WL 2404300 (W. Va. 2014).

[8] *Referencing* Md. Code Ann., Com. Law § 14-1901(9). Specifically, the Court states: "Although federal law allows federally insured banks to charge out-of-state consumers the same interest rate permitted by the bank's home state, regardless of the interest rate caps imposed by the law of the consumer's resident state, 'a credit services business may not, under the MCSBA, assist a consumer in obtaining a loan, from any in-state or out-of-state bank, at an interest rate prohibited by Maryland law.'" (*citing* the lower court opinion).

Ramifications

The Court's view of the licensure requirement and substantive rules under the MCSBA as well as its comments about "true lender" considerations, appear to severely hamper the bank partner model and the accompanying preemption in Maryland, with particular impact on subprime loans that carry interest rates that are above the state's usury limits. While true lender challenges against non-banks remain a viable option for class-action plaintiffs and state regulators, non-banks also would be limited to marketing consumer loans on behalf of out-of-state banks that comport with Maryland's usury laws.[9] As a result, Maryland effectively will have limited rate exportation to strictly those situations where a bank uses its own resources to market, solicit, and originate loans without the assistance of any third parties. Such an application of the MCSBA could provide a basis for banks to challenge the Maryland statute in the future on the grounds that it conflicts with rate exportation authority under federal law.[10]

CashCall v. Md. Com'r of Financial Reg. potentially opens up a new front in the battles challenging the bank partnership model. Heretofore, the primary focus of challenges has been on whether bank partnership loans should be re-characterized as loans by the non-bank partner under a true lender analysis. However the MCBSA as interpreted by the Maryland Court of Appeals separately attacks the bank partner model by asserting that regulatory authority over the non-lending activities of the non-bank suffices to prevent the non-banks from assisting in the originations of loans in excess of the state usury rate. While the theory has been advanced before, albeit rarely,[11] this case by Maryland's highest court may prompt other states to follow suit.

We note that the ultimate reach of federal preemption applied to agents of national banks was also addressed in little discussed language of the Dodd-Frank Act. It provides: "No provision [of the National Bank Act][12] shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate, or *agent* of a national bank (other than a subsidiary, affiliate, or agent that is chartered as a national bank)." (*emphasis added*).[13] While this amendment is recognized for overturning the Supreme Court's decision in *Watters v. Wachovia Bank*, 550 U.S. 1 (2007) (holding that preemption applies to a national bank's mortgage business, whether conducted by the bank itself or through the bank's operating subsidiary), its reference to agents of national banks has not been an area of focus and courts have yet to address the implications of the amendment.

[9] *See, e.g.,* Md. Code Com. Law §§ 12-102, 12-103, 12-306 (ranging from 6-33% per year on consumer loans depending on type of credit extended and dollar amount).

[10] *See, e.g., Beneficial National Bank v. Anderson*, 539 U.S. 1 (2003) (holding that the National Bank Act completely preempted state law usury claims against national banks). Note also that several federal circuit courts have held that Federal Deposit Insurance Act preemption is to be identically applied as National Bank Act preemption in connection with interest rate exportation. *Discover Bank v. Vaden*, 489 F.3d 594, 605 (4th Cir.2007), *rev'd on other grounds without reaching the preemption issue*, 556 U.S. 49 (2009) (quoting *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 295–96 (3d Cir.2005)); see also *Greenwood Trust Co. v. Commonwealth*, 971 F.2d 818, 827 (1st Cir.1992).

[11] *See, e.g.*, *In the Matter of the Investigation of Avant, Inc.*, No. 4835-7860-0239 (May 2016) (state attorney general alleged, among other things, that the non-bank partner fell within the ambit of the West Virginia Credit Services Organization Act). In addition, legislative developments in Connecticut, for example, are indicative of such a trend. Under Connecticut's recently-amended small loan licensing statute, small loans made by federally-insured banks are exempt from all of the provisions of the statute, even if arranged by a non-bank entity on behalf of the bank. However, non-banks generally are subject to the statute's licensing requirements and are prohibited from arranging (or engaging in other licensable activities in connection with) small loans—even exempt bank-made loans—that have annual percentage rates above 36%. See Conn. Gen. Stat. § 36a-557(c).

[12] *See* 12 U.S.C. § 85.

[13] 12 U.S.C. § 25b(h)(2).

Key Takeaways

The Court did not conclude that the loans at issue were invalid under the state usury law. Nonetheless, it in effect held that the MCSBA can be used to attack the structural underpinnings of the bank partnership model. If a company meets the definition of a "credit services business," the MCSBA requires, among other compliance obligations, that:

- The company be licensed;[14]
- It collect any fees only after the full and complete performance of the services that it agrees to perform;[15]
- It obtain a surety bond[16] from a company that is authorized to do business in Maryland;[17]
- It provide its customers with a written "information statement"[18] and a written contract;[19] and
- It not assist a consumer to obtain an extension of credit at a rate of interest which, except for federal preemption of State law, be prohibited under the state's usury limitations.[20]

The MCSBA language immediately above makes plain that the statute precludes a credit services business from assisting in the origination of a loan expressly authorized by federal law. Hence, this tension will no doubt frame preemption battles to come.

Finally, to the extent that bank partnerships and rate exportation are still viable in Maryland, the true lender challenge still remains for non-bank entities seeking to do business in the state. Although the Court failed to establish a definitive standard by which a non-bank entity would be considered the true lender under Maryland law, the Court's opinion is nonetheless instructive as to some of the factors that online lenders operating there should consider to defeat potential true lender challenges, namely:

- Origination charges paid to the bank partner;
- Substantive rights and duties of the bank partner beyond the initial funding of the loan; and
- Non-exclusive rights to own the loans and collect principal, interest, and fees.

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[14] Md. Code Ann., Com. Law § 14-1902(1).

[15] Md. Code Ann., Com. Law § 14-1902(6).

[16] Md. Code Ann., Com. Law § 14-1908.

[17] Md. Code Ann., Com. Law § 14-1909.

[18] Md. Code Ann., Com. Law §§ 14-1904, 1905.

[19] Md. Code Ann., Com. Law § 14-1906.

[20] Md. Code Ann., Com. Law § 14-1902(9).

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