

# Bank Partnerships Update

Online Lenders Alliance Legal Issues Conference

February 12, 2025

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## Agenda

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1. **DIDMCA**
2. **“Reverse Preemption” Bills**
3. **Guidance**
4. **Enforcement**
5. **Class Actions**
6. **Drafting Best Practices**

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## Depository Institutions Deregulation and Monetary Control Act (DIDMCA) <sup>2</sup>

- In 1980, at a time of historically high interest rates, Congress acted to even the playing field between nationally and state-chartered financial institutions
  - Nationally-chartered banks have long been permitted to export home state interest rates
  - Before DIDMCA, state-chartered banks were subject to usury rates of chartering state
  - DIDMCA provides that state-chartered, federally-insured banks may lend in any state at the rate of interest allowed in the state where the bank is located
    - ◆ Contrary state laws preempted
    - ◆ Rate-exportation authority applies to all credit products

## DIDMCA Opt Outs <sup>3</sup>

- DIDMCA permits states to opt out of rate exportation with respect to loans “made” in the state
- Several states initially opted out but later rescinded, leaving only Iowa and Puerto Rico
- In 2023, Colorado enacted an opt out that was recently enjoined (more later)
- Proposed Nevada opt-out initiative failed to garner requisite support
- Other states have proposed opt-out bills:
  - Minnesota
  - Oregon
  - Rhode Island
  - Washington, DC

## Dispute Over Impact of DIDMCA Opt Out

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- DIDMCA opt out applies to loans “made” in the opting out state
- Some argue that this is simply the state where the borrower is located
- Federal authorities indicate otherwise
  - 1988 FDIC Interpretive Letter: where a loan is made “is not necessarily the State in which the bank is located; nor is it necessarily the State in which the borrower is located”
  - 1998 FDIC General Counsel Opinion: where a loan is “made” depends on:
    - ◆ Parties’ choice of law
    - ◆ Where the credit decision is made
    - ◆ Where decision to grant credit is communicated
    - ◆ Where funds are disbursed
- Accordingly, out-of-state institutions may still be permitted to charge their home state rates to borrowers in opt out states in certain circumstances

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## Colorado Opt-Out Litigation

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- Opt-out law challenged by trade associations
- Colorado federal court issues preliminary injunction in June 2024
- Ruling finds that plaintiffs are likely to succeed on the merits of claim that loans to Colorado borrowers are not necessarily “made in” Colorado
- Colorado has appealed; briefing underway in the Tenth Circuit

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## Can States Still Opt Out?

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- Section 525 imposes no deadline on when states may opt out
- Section 525 was never codified, but instead appeared as a statutory note to each of the sections granting rate-exportation authority to various types of federally insured depository institutions – banks, credit unions, and savings and loan associations
  - The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) repealed the provision granting rate exportation to savings and loan associations and with it the reference to opting out
  - However, Section 525 opt-out is still noted in the codification of the rate-exportation provision applicable to banks
  - 2020 FDIC Final Rule regarding state bank interest rate authority says that states “may opt out,” indicating that the agency interprets the opt out to be effective

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## Colorado Court Holds That Ability to Opt Out Has Been Repealed

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In a case involving a Delaware-chartered **bank**, the Colorado Court of Appeals held that FIRREA repealed Section 525 opt-out authority and, therefore, that Colorado’s initial opt out was no longer effective. *Stoorman v. Greenwood Tr. Co.*, 888 P.2d 289 (Colo. App. 1994), *aff’d*, 908 P.2d 133 (Colo. 1995)

- Implies that Section 525 opt-out authority no longer exists and that the 2023 opt-out may be infirm
- Perhaps wrongly decided because of FIRREA’s limited applicability to federally-insured savings and loan associations

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## “Reverse Preemption” Laws

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- Codify concepts from “true lender” cases
- Purport to make a person a “lender” if:
  - They hold the “predominant economic interest” in a loan
  - They are involved in the marketing, brokering, arranging, or servicing of a loan
  - Totality of the circumstances indicates that transaction is structured to evade state law
- Also commonly impose interest rate caps
- Improper attempt to override federal rate exportation authority

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## Who Has Passed a “Reverse Preemption” Law?

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- Existing Laws:
  - California, Connecticut, Illinois, Maine, Minnesota, Nebraska, and New Mexico
- Recently Enacted Laws:
  - Washington and Wisconsin
- Proposed Laws:
  - Alaska, Florida, Maryland, Missouri, and Washington, DC

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## Federal Regulatory Guidance on Bank Partnerships

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### ▪ Interagency Guidance on Third Party Relationships (June 2023)

- Consolidates and replaces prior third-party risk management guidance issued by federal banking agencies
- Highlights include:
  - ♦ Banking organizations are ultimately responsible for conducting activities in a safe and sound manner
  - ♦ Risk management practices should be commensurate with risks posed by third-party relationships
  - ♦ Emphasizes the necessity of sound risk management throughout all five stages of the “third-party relationship life cycle” – (1) planning, (2) due diligence and third-party selection, (3) contract negotiation, (4) ongoing monitoring, and (5) termination

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## Federal Regulatory Guidance on Bank Partnerships (cont.)

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### ▪ Interagency Statement on Potential Risks Associated with Third-Party Deposit Arrangements (July 2024)

- Agencies recognize the benefits of arrangements with third parties to deliver deposit products but caution banks regarding safety and soundness and compliance concerns
- Agencies also simultaneously issued a [Request for Information](#) seeking public input on bank-fintech partnerships, including whether the agencies should update existing guidance

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## State Regulatory Guidance on Bank Partnerships

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- [Ohio Division of Finance Bank Partnership Guidance \(December 2024\)](#): Nonbank entities that are compensated for arranging bank loans of \$5,000 or less must obtain a license
- [Connecticut Department of Banking \(DOB\) Guidance on Amendments to Small Loan Act \(September 2023\)](#): DOB will consider the true lender factors set forth in the state's "reverse preemption" law and case law construing such factors to determine whether loans are subject to Small Loan Act

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## Enforcement Activity - Federal

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- Federal banking agencies recently have focused on third-party risk management and BSA/AML issues
- Series of enforcement actions against banks by OCC, FDIC, and Fed in last two years:
  - BSA/AML/KYC
  - Third-party risk management
  - Fair lending
- Consequences include:
  - Mandatory third-party risk management and BSA/AML practice changes
  - No new partners or products/services without agency approval
  - Fines
  - Ongoing monitoring and reporting
  - "Look-back" reviews for unreported suspicious activity
  - Limits on deposit growth until deficiencies remedied

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## Enforcement Activity - State

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- California DFPI true lender litigation re subprime bank program (LA state court)
  - Preliminary injunction denied in October 2023
  - Trial set for June 2025
- Massachusetts AG AOD re point-of-sale bank program (May 2024)
  - True lender UDAP theory; partner had 90% participation interest in loans
  - Program exits Massachusetts, restitution ordered
  - Similar outcome for same program in Colorado (April 2023), DC (July 2023), and other states
- Oregon federal preemption lawsuit dismissed (January 2025)
  - Auto title lender sought to enjoin state true lender administrative proceeding
  - Court dismissed based on *Younger* abstention
- Washington State also active

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## Class Actions

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- “True lender” class actions are back
  - Jurisdictions
    - ◆ Illinois
    - ◆ California
  - Firms
    - ◆ Warren Terzian LLP
    - ◆ Edelman Combs Latturner & Goodwin LLC
  - Theories
    - ◆ Out: *Madden*
    - ◆ In: Predominant economic interest

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## Class Actions (cont.)

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- Key Strategic Issues:
  - Arbitration
    - ◆ Opt-outs and class certification
    - ◆ Prospective waiver/effective vindication—affects Tribal, but adverse case law could spread
    - ◆ *McGill* (California), *Blair* (Ninth Circuit), and public injunctive relief
  - CAFA removal and equitable jurisdiction (Ninth Circuit)

## Drafting Best Practices: Program Control

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- Agreements must clearly document the roles of the parties
  - The bank is the lender and the partner is marketing and servicing on the bank's behalf
- The bank should conduct comprehensive oversight of the partner throughout the program, including:
  - Pre-launch due diligence and compliance enhancements
  - Control over operations of the program (e.g., approving loan documents and setting underwriting criteria)
  - Ongoing monitoring and periodic audits
  - Termination or suspension of the partnership in certain circumstances

## Drafting Best Practices: Allocation of Risk

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- The bank must bear at least some economic risk
- Hold period:
  - The longer, the better
  - Holding loan through first payment is ideal, but not required
- Purchase of loans:
  - “True lender” recharacterization less likely if partner purchases participation interests, rather than whole loans
  - The higher the participation percentage the bank retains, the better

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