States Expand Regulation of Consumer Lending: Codification of "True Lender" and Opt-out of DIDMCA's Interest Rate Exportation

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Consumer lenders face a rapidly changing legal landscape. States are increasingly targeting the activities of non-bank third parties in the consumer loan process and interest rate exportation by state-chartered banks. In the past, states have sought to enforce their licensing statutes and regulate interest rates through enforcement actions and litigation. These actions by state attorneys' general and bank regulators had primarily targeted predatory loans with high interest rates. Now, state legislatures are changing the rules.

AMENDMENTS TO CONSUMER LENDING STATUTES

Recently, many state legislatures are taking an aggressive approach by revising their consumer lending licensing statutes, specifically attacking the bank partnership model for many consumer loans.

- States such as Hawaii, Maine, Minnesota, New Mexico and Washington have significantly revised their statutes to require a license or registration for a broader range of persons. For example, a state consumer lending license may be required for any person who purports to act as an agent or service provider, or acts in another capacity, for another person that is exempt from the state statute (such as a bank), if the person holds the "predominant economic interest" in the consumer loan; or markets, solicits, brokers, or facilitates the loan and holds a right of first refusal to acquire the loan, receivables or other interest in the loan.
- Some anti-evasion statutes also include a general "totality of the circumstances" test, which can include a person who indemnifies, insures or protects an exempt entity for any costs or risks related to the consumer loan; predominantly designs, controls or operates the loan program; or who acts as a service

provider for an exempt entity, while acting directly as a lender in other states.

- Some states now require a license for loan servicers. For example, Nebraska requires a loan license for ″any person that is not a financial institution who, at or after the time a loan is made by a financial institution, markets, owns in whole or in part, holds, acquires, services, or otherwise participates in such loan.″
- Each state statute has slightly different language and different triggers for applicability. Therefore, it is important to understand exactly what the non-bank entity does in the lending process and review the language of each state′s statutes to determine if they apply to such activities.

AMENDMENTS TO LIMIT INTEREST RATES ON "OFFERED" OR "ARRANGED" LOANS

Other states have enacted consumer protection statutes that limit the interest rate that can be charged on loans offered or arranged by a lender and expanded the definition of ″lender.″

For example, in Illinois a ″lender″ is any person who ″offers or makes a loan, buys a whole or partial interest in a loan, arranges a loan for a third party, or acts as an agent for a third party in making a loan, regardless of whether approval, acceptance, or ratification by the third party is necessary to create a legal obligation for the third party, and includes any other person or entity if the Department determines that the person or entity is engaged in a transaction that is in substance a disguised loan or a subterfuge for the purpose of avoiding this Act.″ By greatly expanding the definition of ″lender,″ Illinois has codified the definition of ″true lender″ and limited many bank partners from charging more than 36% interest (as calculated pursuant to the Military Lending Act).

PENDING LEGISLATION

Other states have introduced bills to codify the ″true lender″ doctrine:

- Bill B25-0609 introduced in the District of Columbia on November 20, 2023, which would add a definition of ″lender″ to the usury and interest statute to cover any person that ″offers or makes a loan, arranges or facilitates a loan for a third party, or acts as an agent for a third party in making or servicing a loan, including any person engaged in a transaction that is in substance a disguised loan or a subterfuge for the purpose of avoiding this chapter, regardless of whether or not the entity or person is subject to licensing, and that (a) holds, acquires, or maintains, directly or indirectly, the whole, predominant, or partial economic interest, risk or reward in the loan; (b) markets, brokers, arranges, facilitates, or services the loan and holds or holds the right, requirement, or first right of refusal to acquire, the loan or

a receivable or interest in the loan; or (c) the totality of the circumstances indicate that the person is the lender and the transaction is structured to evade the requirements of this chapter." The proposal includes a list of items that would be considered that are comparable to those in other states, but adds holding "the trademark or intellectual property rights in the brand, underwriting system, or other core aspects of the loan program." The last action was a public hearing on March 13, 2024.

- Other states that have introduced similar bills include Florida, Maryland, and Missouri, with other states likely to follow suit. Florida's bill died in the Banking and Insurance Committee of the Senate on March 8, 2024. Maryland's and Missouri's bills are still active.

OPTING OUT OF DIDMCA: JEOPARDIZING INTEREST RATE EXPORTATION

A number of states are also targeting a state-chartered bank's right to export interest rates from their home state. While a national bank's interest rate exportation power is derived from the National Bank Act, the power of a federally insured state-chartered bank or credit union to export interest rates from their home state was granted by the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA). Section 525 of DIDMCA granted states the right to opt out of the parity requirements in Sections 521 to 523 of DIDMCA if the state adopted a law specifically opting out of DIDMCA. Originally, seven states and Puerto Rico opted out, but since then every state except Iowa and Puerto Rico repealed those opt out laws. This meant that in every state except Iowa and Puerto Rico, a federally insured, state-chartered bank or credit union could export the interest rate of its home state for a loan made in another state.

Recent developments relating to DIDMCA:

- While Iowa opted-out of DIDMCA shortly after it passed, Iowa has not enforced the opt out until recently. In the last several years, Iowa has undergone a regulatory shift and has instituted enforcement actions against several state-chartered banks making installment loans in Iowa in excess of Iowa's permitted interest rate.
- On June 5, 2023, Colorado enacted HB 23-1229, codified at Colo. Rev. Stat. 5-13-106, which takes effect beginning on July 1, 2024. The statute opts out of DIDMCA for any consumer credit transaction in Colorado made by state-chartered banks, credit unions, and savings and loan associations. An injunction has been requested by several trade organizations challenging the statute on numerous grounds. Oral arguments were heard on May 16, 2024, and the court stated it would issue its decision prior to the July 1st effective date.

- The DC bill referenced above regarding true lender codification, B25-0609, also includes a provision to opt out of DIDMCA.
- Other states that have proposed bills to opt-out of DIDMCA include Minnesota (HF 3680, proposed effective date of August 1, 2024) and Rhode Island (SB 2275, proposed effective date of October 1, 2024). Nevada also has a proposal to opt-out of DIDMCA via a ballot initiative. Given the sharp increase of recent activity in this area, we expect other states will propose similar statutory changes.
- Note regarding federally insured state-chartered savings and loan associations: While the right to opt-out of DIDMCA originally also applied to federally insured state-chartered savings and loan (pursuant to Section 522 of DIDMCA), this right was arguably removed when the portion of DIDMCA applicable to those associations through the National Housing Act of 1934 was repealed and replaced by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and became a provision of the Home Owners' Loan Act . This statutory argument has not been tested. Some states, like Colorado, are attempting to regulate loans in Colorado made by savings and loan associations in addition to state-chartered banks and credit unions.

WHAT DOES THIS MEAN FOR YOU?

If you are a financial services provider in the business of making consumer loans, recognize that the legal landscape is rapidly changing. Financial services businesses need to focus on the laws in every jurisdiction to make sure they have the correct licenses, registrations, and consumer disclosures. These businesses should be careful not to solicit consumers for, offer, or service consumer loans without ensuring their activity is in compliance with the law of each jurisdiction where the product is offered. Banks also need to be aware of how these changing statutes apply to their non-bank partners and impact the bank. State banks and credit unions need to be particularly aware of the states legislating to opt out of the exportation of interest rates.

For more information on the regulation of consumer lending, please contact Mike Lochmann, Maria Macoubrie, Thomas Witherspoon or the Stinson LLP contact with whom you regularly work.

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