FinReg Round-Up

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In this month's FinReg Round-Up, the focus is on disclosure and the future of fintech's relationships with banks. A new law is set to be enacted in New York that will mandate that commercial financing providers give borrowers important information about the offer on the table before acceptance. The Office of the Comptroller of the Currency (OCC) has introduced proposed regulations aimed at defining the "true lender" behind a loan made in partnership with a nonbank lender. Finally, some banking trade groups would like the Federal Deposit Insurance Company (FDIC) to put on hold its plans to formalize certain aspects of the process of obtaining an industrial bank charter until the agency addresses their concerns.

A number of fintech companies have been interested in chartering their own banks, in part due to the uncertainty regarding true lender issues. The pressure to limit the industrial bank charter by requiring industrial bank parent companies to be supervised and regulated by the Federal Reserve, along with the uncertain future of the OCC's fintech charter due to ongoing litigation, means that fintech companies face increasingly limited options with respect to their banking relationships.

A New Commercial Financing Disclosure Law

New York Gov. Andrew Cuomo is poised to sign a bill (A10118A / S5470B) that requires certain commercial financing providers to disclose key information to borrowers on the offer before acceptance. Information to be disclosed includes the financing amount, finance charges, annual percentage rate, total repayment amount, term, payment amounts, other potential fees and any prepayment costs. Providers also must give borrowers a description of any collateral requirements.

The new law targets four categories of commercial financing: sales-based financing, closed-end commercial financing, open-end commercial financing and factoring transactions. It's intended to protect small businesses—which make up 99.8% of all businesses in the state and employ more than 50% of the private workforce—by increasing transparency surrounding the financing.

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Exemptions apply for financial institutions, certain technology service providers, lenders regulated under the federal Farm Credit Act, commercial financing secured by real property, leases as defined in the Uniform Commercial Code, providers conducting five or fewer commercial financing transactions a year, and individual commercial finance transactions that exceed $500,000.

Who's Your Loan's 'True Lender'?

The OCC has drafted proposed rules that would determine whether a national bank or federal savings association is considered the true lender of a loan made under a partnership program between the bank and a third party. The proposed rule is the latest salvo by the OCC in a decadeslong battle with states over the scope of preemptive powers of national banks. A full discussion of the history and nuances of the preemption battle are far beyond what we can fit into the Round-Up. For those who are curious, the Congressional Research Service has issued a good overview of the history of bank preemption.

For purposes of the current OCC proposal, under federal law, national banks can charge nationwide any interest rate that is permissible in the bank's home state, thereby preempting individual state usury statutes. Banks have increasingly entered into partnerships with online nonbank lenders that advertise, process and service loans made by banks and then are typically sold to the nonbank lender after origination.

Federal law does not define, in the context of these partnerships, which entity is the true lender and therefore what legal framework applies to the loans. In the absence of statutory or regulatory guidance, the courts have applied a patchwork of standards for resolving the issue.

The proposed rule specifies that a bank makes a loan and is considered the true lender if, as of the date of origination, it is either named as the lender in the loan agreement or funds the loan. The OCC is adopting the true lender standard applied in *Sawyer v. Bill Me Later* and similar cases of looking to the loan documents themselves, instead of the "predominant economic impact" standard that has been used to challenge partnerships between banks and tribal banks and lenders (mostly payday lenders). This approach is not surprising given that, under the predominant economic standard (i.e., the entity in the partnership with the predominant economic interest is the true lender), the bank would almost never be found to be the true lender under the typical partnership mode.

Republican members of the House Financial Services Committee sent a letter to the OCC and FDIC in support of the proposed rule, noting that small businesses need access to affordable credit more than ever due to the COVID-19 pandemic and resulting economic slowdown.

Critics, including consumer groups, state regulators and other members of Congress, argue that the proposed rule could open the door to lending abuses. The Conference of State Bank Supervisors, the nationwide organization of banking and financial regulators, said in a statement that issues related to credit affordability and access are inherently local concerns and should be addressed by state regulators, and that OCC's proposed rule would erode state consumer rights and protections.

The deadline to submit comments on the proposed rule is Sept. 3.

Large and Small Banks Unite Against FDIC's Industrial Bank Charter Plans

Trade groups representing large banks are speaking out against the FDIC's proposed changes to the requirements for obtaining an industrial bank charter. Parent companies of industrial banks and industrial loan companies are exempted from the definition of bank holding company under the Bank Holding Company Act, meaning the parent companies are not subject to Federal Reserve supervision or restrictions on nonfinancial activities. The exemption has allowed nonfinancial companies such as auto manufacturers and retailers to charter their own bank.

The FDIC's proposed rule would require that certain conditions be met and commitments made for every deposit insurance application approval from an industrial bank or industrial loan company (ILC). The rule would ensure that the parent company of a covered industrial bank approved for deposit insurance serves as the source of strength for the industrial bank. Currently, similar commitments from industrial banks and their parent companies are obtained on an ad hoc basis through letter agreements. The proposed rule would also provide some transparency to future applicants and the public about what the FDIC requires of those parent companies.

Meanwhile, the FDIC has approved deposit insurance applications for the first new industrial banks in the United States in over a decade. Concerns over large retailers obtaining a bank charter and the potential associated dominant market power caused the FDIC to cease approving deposit insurance applications in 2008 pending further study and analysis. More applications are on the way, raising concerns about nonfinancial organizations, including tech companies, getting into the banking business.

The FDIC's industrial bank ownership application plans have united trade groups representing both big and small banks, including the Consumer Bankers Association, American Bankers Association and Independent Community Bankers of America, in opposing regulatory changes that would allow new players to obtain industrial bank charters.

Recently, the Bank Policy Institute (BPI) urged the FDIC to lobby Congress to prohibit nonfinancial companies from setting up their own industrial banks. It also asked the FDIC to impose a moratorium on processing deposit insurance applications for new industrial banks until concerns can be addressed. The BPI pointed out that, among other issues, it's unclear whether parent companies of industrial banks and ILCs will be subject to restrictions on their engagement in nonfinancial activities and to federal privacy and data security standards.

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