FinReg Round-Up
December 2020

Vol. 1 No. 9

Largest U.S. Payments Companies Will Be Subject to Just One State Exam in 2021 1

PPP Loan Borrowers Must Complete SBA 'Loan Necessity' Questionnaire. 2

OCC Issues True Lender Rule 3

As we head into the holiday season and the end of 2020, we wanted to take a moment to wish you good health and safety as we close out a very challenging year and look forward to better times ahead in 2021.

For this month's FinReg Round-Up, we highlight some relief for state-licensed money transmitters through a more coordinated state exam process; the U.S. Small Business Association's (SBA) Paycheck Protection Program (PPP) draft "loan necessity" questionnaire and the possible implications for PPP borrowers; and the Office of the Comptroller of the Currency's (OCC) "true lender" final rule.

For state-licensed money transmitters, next year will bring a bit of relief: a move to one comprehensive state exam to meet all requirements set by the states, as the Conference of State Bank Supervisors (CSBS) launches its program for money transmitters operating in 40 or more states.

As we move into the forgiveness phase of the PPP, businesses with loans of $2 million or more have new paperwork to complete—a loan necessity questionnaire from the SBA aimed at the good-faith certification of necessity applicants made at the time of application. And with its Oct. 27 announcement of a new rule, the OCC has once again ventured into the thorny issue of what determines whether a national bank or federal savings association is the "true lender" of a loan made through a partnership between the bank and a third party.

Largest U.S. Payments Companies Will Be Subject to Just One State Exam in 2021

Because money transmission is primarily regulated at the state level, fintech and payments companies engaging in money transmission face different licensing requirements and examination requirements and schedules from each state. The CSBS Fintech Industry Advisory Panel has been looking at ways to better streamline and coordinate state money transmitter exams to reduce the administrative burdens on both licensees and state regulators.

Starting next year, money transmitters operating in 40 or more states will be subject to only one comprehensive state exam to meet all requirements set by states. The program applies to 78 of the largest payments and cryptocurrency companies in the United States, which combined move an excess of $1 trillion a year in funds.

Attorney Advertising

Under the new initiative, known as MSB Networked Supervision, examiners—experts in financial issues including cybersecurity and anti-money laundering measures from around the country—will lead each exam and be overseen by one state. MSB Networked Supervision provides a new exam framework that will enable states to tailor their approach to each company's operations and allow for timely follow-up when compliance issues arise.

The program was developed after the successful completion of CSBS's "One Company, One Exam" pilot in 2019 and early 2020, with support by members of the Money Transmitter Regulators Association.

PPP Loan Borrowers Must Complete SBA 'Loan Necessity' Questionnaire

The U.S. Small Business Administration (SBA) has quietly announced that it will require PPP borrowers of $2 million or more to provide detailed financial information regarding a number of metrics in a loan necessity questionnaire. The questionnaire was disclosed in a routine administrative notice requesting official approval from the Office of Management and Budget for a number of PPP-related forms that were issued on an emergency basis earlier in the year. The questionnaire itself was not a part of the notice (just the name and number of the form), and it is not yet final or available on the SBA's website. However, drafts of the questionnaire quickly began circulating.

The draft questionnaire is nine pages long, and, according to the SBA, the information collected in the form will be used to "inform SBA's review" of the borrower's "good-faith certification that economic uncertainty made your loan request necessary to support your ongoing operations." The SBA and Department of the Treasury had previously announced that they would automatically review all PPP loans of $2 million or more, but this is the first indication of the criteria the SBA will use as part of that review.

The questionnaire asks for a number of activity and liquidity metrics, including:

- The borrower's gross revenue in the second quarters of 2019 and 2020
- Whether and how the borrower either mandatorily or voluntarily altered its operations since March 13, 2020
- Whether the borrower paid dividends, made distributions or prepaid any outstanding debt
- Whether any employees or owners received compensation greater than $250,000 on an annualized basis during the PPP loan's covered period
- Whether the borrower is publicly traded or owned in part by a hedge fund or private equity firm, or venture capital firm

These metrics go far beyond what is required under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and PPP regulations and guidance. Borrowers were required to certify that the loan was "necessary to support the ongoing operations" of the borrower, but no criteria were given for making this determination. There also were no prohibitions on use of the borrower's non-PPP funds, and no requirement that the PPP loan be the borrower's last resort. Borrowers were requited to make the certification at the time of application and have not been required to provide an update. The SBA states in the questionnaire that the evaluation of loan necessity will be based on "the totality of the circumstances," although it has been clear for several months based on guidance and public statements that publicly traded companies and companies with perceived other sources of liquidity (such as private equity fund portfolio companies) will be viewed with some skepticism.

How the SBA will evaluate the information collected from the questionnaire or evaluate loan necessity remains unclear. For example, if a business ended up being more profitable than expected but it had a reasonable basis at the time of the PPP application based on the initial impact of COVID-19 to conclude that the funds were needed to support ongoing operations, will the SBA deem that loan to have not been necessary? If so, will the borrower be deemed to have made the certification not in good faith? Given that the SBA has six years from the date of forgiveness or repayment of any PPP loan to audit the loan, it could be some time before the SBA's internal criteria for "loan necessity" become apparent.

We expect that the "loan necessity" questionnaire will be finalized in the next few weeks, and lenders with PPP loans of $2 million or more should expect to hear from their lenders regarding the form.

OCC Issues True Lender Rule

The OCC issued a final rule on Oct. 27 that establishes clear criteria regarding whether a national bank or federal savings association is the "true lender" of a loan made in a partnership between the bank and a third party. The final rule as adopted is substantially similar to the proposed rule issued earlier this year.

Bank partnerships with third parties to provide consumer credit have existed for some time, but have increased in popularity in recent years as people rely more and more on technology for their financial transactions. An ongoing controversy exists regarding whether these bank partnerships are part of the business of banking and help provide greater access to affordable credit, or are simply a way for a non-bank lender to engage in "rent-a-charter" activity and avoid state usury limits and consumer protection laws. Court cases have established two different standards for determining a "true lender" in a bank partnership lending program: The lender is either the party that (1) has the predominant economic interest in the transactions, or (2) is identified as the lender on the documents. Under the first standard, the third party and not the bank will typically be found to be the true lender, while under the second standard, the bank will typically be found to be the true lender.

In its final rule, the OCC definitively adopts the second standard, stating that a bank making a loan is considered the true lender if, as of the date of origination, it is named as the lender in the loan agreement or funds the loan. The rule additionally clarifies that if a bank is named the lender in the loan agreement but another bank funds that loan, the bank named as the lender makes the loan. The true lender of a loan retains all compliance obligations associated with the origination of that loan. The OCC emphasizes that "if a bank fails to satisfy its compliance obligations, the OCC will not hesitate to use its enforcement authority consistent with its longstanding policy and practice."

The rule is the OCC's latest move in a decades-long battle with states to define the preemptive powers of national banks and has drawn criticism from state financial regulators, consumer advocates, and members of Congress who argue that, among other problems, the rule allows predatory lenders to get around state usury and consumer protection laws. The OCC argues that the loans are made by a regulated institution (a national bank or federal savings association) and that OCC supervision and examination will curtail any abusive or predatory practices.

Related Professional

Melissa Hall . . . . mhall@loeb.com

6526 REV2 12-04-2020