

Morgan Lewis

TECHNOLOGY MAY-RATHON

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TECHNOLOGY-BASED LENDING**

Charles Horn
Melissa Hall

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Morgan Lewis Technology May-rathon

Morgan Lewis is proud to present Technology May-rathon, a series of tailored webinars and in-person programs focused on current issues, trends, and developments related to technology that are of key importance to our clients.

This year is our 7th Annual May-rathon and we are offering 25 in-person and virtual events related to the new administration, disruptive technologies, issues in global tech, cybersecurity, and others.

Full listing and recordings of our tech May-rathon programs can be found at <https://www.morganlewis.com/topics/technology-may-rathon>

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Welcome and Webinar Logistics

The webinar is audio listen only so feedback and questions will not be taken verbally. We will have interactive Q&A capabilities throughout the webinar; however, all questions will be answered at the end. The Q&A tab is located on the bottom right hand side of your screen. Please type your questions in the space provided and click Send.

Participation in this webinar is mandatory for all attendees who requested CLE credit. We will provide the CLE code at the end of the presentation.

We would appreciate any feedback you have on today's presentation and any other topics we should consider adding to our curriculum, please take a few minutes and fill out our post-event survey sent to you by WebEx.

What Is Technology-Based Lending?

- Can cover a broad range of activities involving the intersection of technology and financial services (also known as FinTech)
 - Banking apps and websites
 - Payment apps
 - Back-office systems
 - underwriting, credit checks, identity verification
 - Intermediation and referral platforms
 - Payment processing and card network systems
 - ACH, FedWire, Visa, MasterCard, American Express, Discover
 - User and data analytics
 - Mobile wallets

Today's Agenda

- Regulatory issues that arise in connection with
 - Marketplace lending
 - Online direct lending
 - Lender intermediation and support platforms
- Cybersecurity
- OCC FinTech Charter and recent developments

Marketplace Lending

- “Peer-to-Peer” lending or “crowdfunding”
- Some marketplace lenders/providers allow third-party investment in loans
- Can use both traditional and nontraditional underwriting criteria
- Bank partnership/marketing model
- Mostly consumer; an increasing number of small business lenders

Online Direct Lending

- Similar to marketplace lending
 - Third-party investment in loans
 - Traditional or alternative underwriting criteria
- Does not use the bank partnership/marketing model
- Lenders obtain state lending licenses and lend under those licenses

Typical Bank Partnership Model

- Marketplace provider partners with a bank to develop underwriting criteria
- Marketplace provider is the customer-facing entity (branded website, etc.)
- Bank originates the loan
- Bank sells the loan to the marketplace provider, typically after a few days
- Marketplace provider engages in servicing and collections
- Marketplace provider considers itself a bank service provider and not a “lender”

Bank Partnership Model Regulatory Issues

- “True Lender”
 - Can the contract designate the lender at origination (i.e., the bank) or will the party with the “predominant economic interest” be the “true lender”?
- “Valid when made”
 - National banks and state banks can “export” the interest rate of their home state to loans originated to borrowers in other states
 - If a loan was valid at origination with respect to state usury laws due to federal preemption, the general rule is that the loan remains valid if purchased by a subsequent buyer
 - *Madden v. Midland Funding* may (or may not) call this rule into question
- The marketing platform may be treated as a service provider to the bank and subject to supervision and oversight by federal or state regulatory agencies (banking agencies, Consumer Financial Protection Bureau (CFPB), etc.)

True Lender and Valid When Made

The scope and applicability of both doctrines are developing through the courts, often with seemingly inconsistent outcomes

BillMeLater

CashCall cases

Madden v. Midland

Think Finance

Colorado v. Marlette Funding

Alternative Underwriting Criteria

- Some marketplace lender and direct lender models focus on “alternative” underwriting criteria as an alternative to credit scores and other traditional criteria
- Goal is to provide credit to underserved population, recent graduates, people with future earning potential, people with little credit history
 - College attended
 - Grades and GPA
 - Work history
 - Potential future income
 - Social media profile
 - Savings, bill payment, and spending habits
 - Bank account and retirement account balances

Lender Intermediation and Support Platforms

- Financial technology providers and services that support online lender programs, but do not actually engage in lending activities
 - Lender referral programs
 - Loan technology support services (application facilitation, document review and processing, etc.)
- Most intermediaries offering these services structure them to avoid or minimize federal and state licensing and other regulatory requirements
- If these providers are doing business with banks or other consumer financial lending firms, they still may be treated as service providers that are subject to federal or state regulatory and supervisory oversight

Consumer Regulatory Risk

- Fair lending risk
 - Equal Credit Opportunity Act and Regulation B make it unlawful for:
 - any creditor to discriminate against any applicant with respect to any aspect of a credit transaction (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.
 - Applies to both intentional discrimination (disparate treatment) and facially neutral conduct that results in discrimination (disparate impact)
 - Applies to both consumer and commercial lending

Consumer Regulatory Risk

- Mitigating fair lending risk
 - Consider whether criteria used in application and underwriting could favor one group over another
 - Test the models before implementation for pricing differentials that appear to vary based on protected status of applicants
 - Ongoing testing of use of discretion (which should be minimized), models, and results (disparate impact testing)
 - Disparate impact occurs when a creditor employs facially neutral policies or practices that have an adverse effect or impact on a member of a protected class unless it meets a legitimate business need that cannot reasonably be achieved by means that are less disparate in their impact
 - Testing and careful design of models can help support a defense to disparate impact

Consumer Regulatory Risk

- UDAAP risk – Unfair, Deceptive, or Abusive Acts or Practices
 - CFPB has federal UDAAP enforcement authority
 - FTC and state AGs also have UDAP enforcement authority (doesn't include "abusive")
- CFPB continues to be aggressive in its UDAAP enforcement cases
 - Attempting to collect loans for which the lenders should have had a state license (true lender issue) is "deceptive, unfair and abusive" (*Golden Valley Lending, Inc.*)
 - Claiming "state of the art" technology or security when the technology is not "state of the art" is "deceptive" (*Dwolla, Inc.*)
 - Technology breakdowns impacting financial consumers can be "unfair acts or practices" (*UniRush LLC*)
- Marketing materials and websites need to accurately describe the products and services, function as advertised, and be properly maintained

Consumer Regulatory Risk

- Other federal consumer laws
 - Truth in Lending Act and Regulation Z
 - Fair Credit Reporting Act
 - Fair Debt Collection Practices Act
 - Electronic Funds Transfer Act and Regulation E
- Mortgage lending requirements
 - Real Estate Settlement Practices Act (RESPA)
 - Dodd-Frank Act mortgage originator rules (Regulation Z)
 - Areas where caution may be advised in the virtual environment may include (i) referral fees to intermediaries (RESPA anti kickback restrictions) and (ii) services that could fall under mortgage brokering or origination requirements (CFPB mortgage originator rules under Regulation Z)

State Loan Regulation

- Consumer lending requires state licenses
 - Licensing requirements vary according to loan type and nature of loan-related activity
 - In particular, real estate-secured loans are subject to more extensive licensing and regulation
- Commercial lending also requires licenses, but in only a handful of states
 - CA (California Finance Lenders Law) is a prime example of one of these states
- In the direct lender model, the nonbank lender obtains state licenses
- In the bank partnership model, the bank as lender is exempt from state lender licensing laws
 - Marketplace provider is a service provider, not a lender

State Loan Regulation

- Based on the activities of the marketplace provider in the state, some states may require a marketplace provider to obtain a state lending or brokering license even if there is a bank partner
- There may also be state licensing requirements for, or restrictions on, servicing, collections, or purchasing loans
- Therefore, don't assume that a bank partnership model means no licenses are needed

Cybersecurity

- Major focus of state and federal regulators
 - Safety and soundness issue for banks
- Implicates a number of risk factors
 - UDAAP/UDAP
 - Federal and state consumer privacy safeguarding requirements
 - Consumer class actions
 - State data breach law violations
 - Reputational damage

Cybersecurity

- NYDFS Cybersecurity Rule (March 2017)
 - Applies to entities regulated by the NYDFS
- Federal banking agency (OCC, FRB, FDIC) joint advance notice of proposed rulemaking (ANPR) on enhanced cyber risk management standards (October 2016)
 - Would be primarily applicable to large banks and their service providers
 - Agencies proposed a tiered, risk-based approach
 - Rules or guidance? Not yet decided. Does it matter?
- As bank service providers, nonbank FinTech companies are already subject to supervision and examination, as well as the bank's own cybersecurity standards
- FinTech providers must conduct due diligence of their own technology providers and testing of systems to ensure adequate cybersecurity

OCC FinTech Charter

- OCC has proposed to start accepting applications from technology companies for a special purpose national bank charter (FinTech charter)
- Most recently, OCC released a proposal for the FinTech charter application, but has not finalized the process
- Recipients of FinTech charter would be regulated as special purpose banks, similar to credit card banks
 - Most significantly, holders of a FinTech charter would not be subject to state lending license requirements or state usury limits (other than their home state's limits) by reason of federal preemption

OCC FinTech Charter

- State financial regulators have objected to the charter as exceeding the OCC's chartering authority and avoiding state regulation
- Conference of State Bank Supervisors filed a lawsuit against the OCC in US District Court for the District of Columbia to enjoin the OCC from granting FinTech charters
- The New York Department of Financial Services has separately sued in US District Court for the Southern District of New York in Manhattan to block the FinTech charter
- Future of the FinTech charter, and the charter's utility for FinTech companies, is uncertain

Biography



Charles M. Horn

Washington, D.C.

T +1.202.739.5951

charles.horn@morganlewis.com

Charles M. Horn counsels US and international banks and other financial institutions on corporate, regulatory, supervisory, enforcement, and compliance matters before all major federal and state financial regulatory agencies. He advises clients on major federal financial services statutes and regulations, as well as on US and international financial reform developments. Charles also counsels banks and other financial services firms on issues affecting their governance, structure, management, and operations.

Biography



Melissa R. H. Hall

Washington, D.C.

T +1.202.739.5883

melissa.hall@morganlewis.com

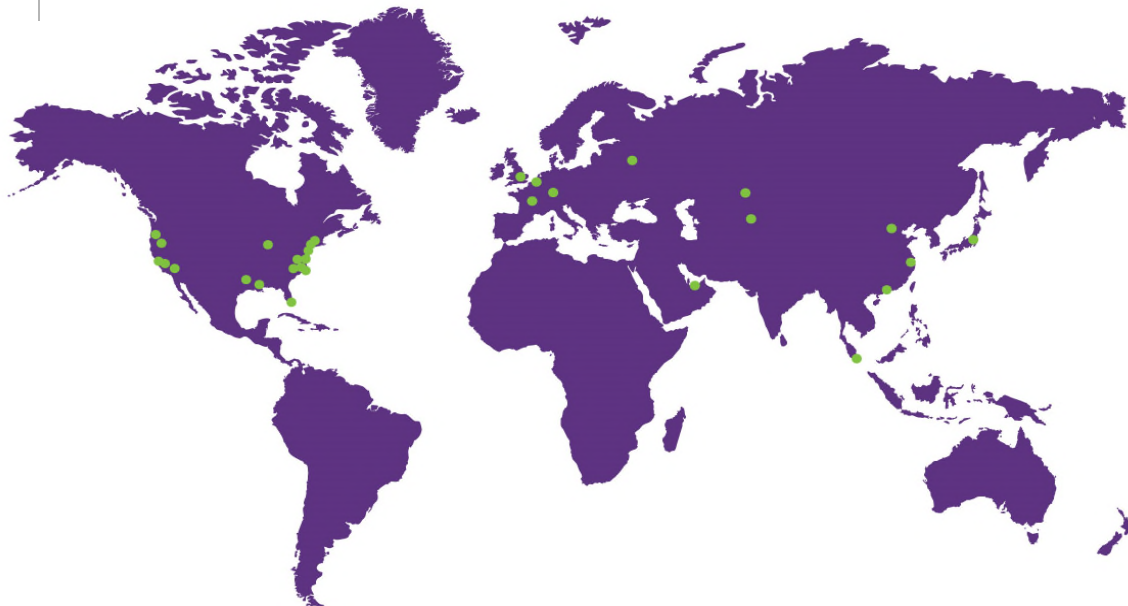
Melissa R. H. Hall represents US and overseas banks, nonbank financial services companies, investors in financial services, and technology companies in regulatory and corporate matters. She advises them on a wide range of state and federal financial regulatory laws and regulations. She provides counsel on financial regulatory compliance and enforcement, including state and federal licensing requirements, consumer financial products and compliance, payment systems, corporate and transactional matters, financial institution investment and acquisition, and the development of new financial services products.

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