AFSA
AMERICAN FINANCIAL SERVICES ASSOCIATION

The Critical Need for Federal True Lender Legislation

Supporting Re-Introduction of the Modernizing Credit Opportunities Act

Executive Summary

The U.S. financial system faces a critical regulatory gap that threatens to fragment national credit markets. Following the Congressional Review Act repeal of the OCC's True Lender Rule in 2021[1], no federal framework exists to determine true lender status in arrangements[2] between federally insured depository institutions and financial technology companies ("fintechs"). This vacuum has enabled inconsistent state approaches that conflict with federal preemption principles, and threaten both the valid when made rule and bank-fintech partnerships serving millions of U.S. consumers to access affordable credit.

Congress must re-introduce and enact the Modernizing Credit Opportunities Act ("MCOA") (H.R. 4439) to establish uniform federal standards for true lender determinations while preserving the interconnected framework of federal banking law and a level paying field for our dual banking system.

The Interconnected Foundation: Valid When Made and True Lender Doctrines

The valid when made rule and true lender doctrine work in tandem to support the federal banking system and a nationwide credit marketplace.[3] While addressing distinct legal questions, they are inextricably linked: the true lender doctrine determines which entity originated a loan and which law governs a loan's terms, while the valid when made rule determines whether those terms remain enforceable throughout the loan's lifecycle. Together they provide the reliability needed for a functioning national credit marketplace and credit availability for the greatest number of borrowers.[4]

The valid when made rule has been a cornerstone of U.S. banking law for over a century. As the U.S. Supreme Court stated, "a contract, which, in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction."[5] This rule enables secondary markets for securitized debt to flourish, enhancing liquidity and reducing credit costs nationwide.

The rule faced a threat in 2015 when the Second Circuit's *Madden v. Midland Funding* decision allowed state usury laws to apply to loans after assignment, although they were validly made by national banks.[6] This created market uncertainty until federal regulators intervened. In 2020, the FDIC and OCC issued regulations clarifying that loan interest permissibility "is determined at the time the loan is made" and "is not affected by sale, assignment, or other transfer."[7] These regulations have received consistent judicial support and restored confidence.[8]

However, the benefits of the valid when made rule can only be realized where there is certainty about which entity is the "true lender."

The True Lender Crisis: State Fragmentation Undermines Federal Law

<u>The Regulatory Vacuum</u>: The OCC True Lender Rule repeal created a critical federal oversight gap. No comprehensive framework currently exists to determine true lender status in partnerships between federally

insured institutions and fintech companies.[9] This vacuum has enabled inconsistent state approaches threatening uniform federal banking law application.

State Fragmentation Creates Regulatory Chaos: Six states have codified conflicting true lender tests—Illinois (2021), Maine (2021), New Mexico (2022), Minnesota (2023), Connecticut (2023), and Washington (2024)—while Colorado attempted a DIDMCA opt-out in 2023 (currently enjoined).[10] Additional states including Maryland, Florida, and D.C. have introduced similar legislation.[11] These laws employ either indeterminate "predominant economic interest" standards or subjective "totality of circumstances" analyses designed to potentially recharacterize bank loans as non-bank loans, forcing banks, their partners and third parties to navigate conflicting jurisdictional requirements.

Federal Preemption Under Attack: State true lender laws fundamentally conflict with established federal banking principles. Under Section 521 of the DIDMCA, federally insured state-chartered banks enjoy the same interest rate exportation authority as national banks.[12] State laws recharacterizing these institutions as non-lenders effectively nullify federal preemption and undermine the competitive equality Congress established.[13] The Federal Deposit Insurance Act ("FDIA") expressly affirms that conflicting state laws are "hereby preempted."[14] State laws overriding federal lending determinations directly contradict this express preemption.

Economic Stakes and Constitutional Foundation

Innovation and Consumer Access at Risk: Bank-fintech partnerships have become essential to modern credit ecosystems. Federal regulators recognize that these partnerships enable institutions to supplement, enhance, and expedite lending services while reducing costs, expanding credit access, and achieving strategic goals.[15] These partnerships enable state-chartered banks, community banks and credit unions to compete through technology, expand access for underserved populations (particularly near-prime and subprime borrowers[16]), drive lending innovation, and reduce borrowing costs through competitive pressure.[17]

Legal uncertainty increases compliance costs and liability risks, forcing institutions to exit markets or discontinue products. This particularly disadvantages state-chartered banks, which originate most fintech partnership loans and depend on the DIDMCA for nationwide lending authority. Courts have applied varying standards, creating uneven legal landscapes undermining Congressional competitive equality intentions.[18]

Constitutional Authority for Federal Action: The MCOA rests on solid constitutional foundations. Interstate lending partnerships fall within Congressional Commerce Clause authority. The MCOA's findings recognize that inconsistent state approaches "jeopardize substantial benefits of third-party lending arrangements for borrowers and the economy."[19] Federal banking law must take Supremacy Clause precedence over conflicting state approaches.[20] The Supreme Court in *Marquette National Bank v. First of Omaha Service Corp.* established federal authority over interest rate exportation, providing a foundation for extending similar principles to true lender determinations.[21]

The Solution: The MCOA

H.R. 4439, introduced by Representative Trey Hollingsworth in 2017, provides the comprehensive federal framework needed to restore uniform national standards for both true lender determinations and valid when

made protections. The MCOA establishes that federally insured depository institutions are true lenders when they are the party to which debt is initially owed according to loan terms, regardless of subsequent assignments or third-party service relationships. The legislation applies uniform standards across all federally insured institutions—national banks, state banks, and federal savings associations—ensuring competitive equality while clarifying that service provider geographic location does not affect institutional location determinations.[22] Full text *available at: https://www.congress.gov/bill/115th-congress/house-bill/4439/text]*

Regulatory Support and Industry Benefits: Federal banking regulators consistently support MCOA principles. The Federal Reserve, FDIC, and OCC have published guidance acknowledging bank-fintech partnerships' benefits while establishing risk management standards.[23] Federal regulators have endorsed the related valid when made rule through comprehensive regulations, demonstrating regulatory support for uniform federal banking standards.[24]

The financial services industry has prioritized federal true lender legislation through legislative advocacy and strategic litigation. The ongoing Colorado DIDMCA opt-out challenge resulted in a federal court preliminary injunction, demonstrating constitutional problems with state approaches and continued market uncertainty.[25] Trade associations representing banks, fintech companies, and financial services providers have endorsed federal legislation as essential for providing the certainty needed for continued innovation and consumer service.[26]

Congressional Action Required

Immediate Priority: Congress should re-introduce and prioritize MCOA passage to establish uniform federal true lender standards across all federally insured institutions, preserve valid when made protections through clear origination standards, preempt conflicting state laws undermining federal banking authority and competitive equality, and provide legal certainty for beneficial bank-fintech partnerships.

Long-term Economic Benefits: Federal legislation would restore competitive equality between state and national banks as the DIDMCA intended, promote continued financial services innovation, expand consumer access to competitive credit products (particularly for underserved populations), strengthen the dual banking system by ensuring state-chartered institutions can compete effectively, and support secondary markets by providing certainty that loan terms remain stable after assignment.

Conclusion: Federal Leadership Essential

Proliferating inconsistent state true lender laws threaten decades of federal banking policy promoting uniform national credit markets. Just as federal regulators provided essential valid when made clarity through bipartisan regulatory action, Congress must now provide parallel true lender leadership.

The MCOA offers a sensible, carefully crafted framework addressing these challenges while supporting innovation and competition benefiting U.S. consumers. The MCOA's Congressional findings demonstrate thorough consideration of economic and regulatory issues, while specific provisions provide legal certainty needed for continued market development.

The stakes are substantial: in an era of rapid technological change and evolving consumer financial needs, the federal banking system must adapt and innovate while maintaining legal certainty underlying efficient

credit markets. The interconnected nature of valid when made and true lender doctrines requires comprehensive federal action to preserve both principles.

Federal true lender legislation is essential for maintaining stability, innovation, and competitive dynamics that have made U.S. financial markets the strongest globally. Congress should act swiftly to re-introduce and enact the MCOA.

This brief is submitted by the American Financial Services Association (AFSA) in support of federal legislation to establish uniform true lender standards for federally insured depository institutions engaged in third-party lending partnerships.

Endnotes

[1] S.J. Res. 15, 117th Cong. (2021) (repealing OCC True Lender Rule), available at https://www.congress.gov/bill/117th-congress/senate-joint-resolution/15.

[2] Sometimes referred to as "partnerships", these arrangements take on a variety of structures which beg for a reliable regulatory solution. A reliable regulatory solution would provide needed clarity for appropriate structuring to obtain the benefits of these structures. These arrangements have been long recognized by federal bank regulators as generally positive and contributive to a sound and vital financial services industry and to the businesses and consumer that rely upon the credit provided by the banking industry. *See, e.g., Interagency Guidance on Third-Party Relationships: Risk Management*, FIL-29-2023 (June 6, 2023); FDIC Credit Card Activities Manual, Chapter XIV (May 24, 2007); and their precedents and subsequent guidance. Arrangements between banks and fintech companies are only the latest iteration of these kinds of arrangements. Banks entered into similar relationships with retailers shortly after the U.S. Supreme Court's decision in *Marquette Nat. Bank of Minn. v. First Omaha Serv. Corp*., 439 U.S. 299 (1978). *See, e.g.,* the Ameritrust Credit Card Program for the Firestone Tire & Rubber Company (1985) and other early private label credit programs established for various retailers and manufacturers. Although facing substantially similar concerns, these programs were rarely criticized by state or federal regulators. The *Marquette* case itself involved a bank and a separate service company, with no suggestion that the service company was extending credit as the "true lender," despite its involvement in marketing and other functions. 439 U.S. at 304-305.

[3] *Venable LLP, The OCC Draws a Bright Line for Determining the True Lender (Oct. 2020), available at https://www.venable.com/insights/publications/2020/10/the-occ-draws-a-bright-line-for-determining-the (explaining that "The so-called Madden issue actually involves two separate legal questions" addressed by "the valid when made doctrine and the true lender issue," and that the OCC said "the ability to transfer loans is an essential funding tool for banks, allowing them to manage liquidity and enhance safety and soundness")*.

[4] Congress intended to facilitate what Representative Hooper termed a "national banking system." Cong.Globe, 38th Cong., 1st Sess., 1451 (1864).

[5] *Nichols v. Fearson*, 32 U.S. 103, 109 (1833).

[6] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

[7] Federal Interest Rate Authority, Final Rule, 85 Fed. Reg. 44146 (July 22, 2020), available at https://www.federalregister.gov/documents/2020/07/22/2020-14114/federal-interest-rate-authority; Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, Final Rule, 85 Fed. Reg. 33530 (June 2, 2020), available at https://www.federalregister.gov/documents/2020/06/02/2020-11963/permissible-interest-on-loans-that-are-sold-assigned-or-otherwise-transferred.

[8] *Lutz v. Portfolio Recovery Assocs., LLC*, 49 F.4th 323, 335 (3d Cir. 2022).

[9] See supra note 1.

[10] American Bar Association, True Lender and Rate Exportation: Reviewing the Major 2023 Legislation (Apr. 2024), available at https://www.americanbar.org/groups/business_law/resources/business-law-today/2024-april/true-lender-and-rate-exportation-reviewing-the-major-2023-legislation/; see also American Bar Association, FinTech Regulation: True Lender Legislation, DIDMCA Opt-Out, and Enhanced Federal Scrutiny (Spring 2024), available at https://www.americanbar.org/groups/business_law/resources/business-lawyer/2024-spring/fintech-regulation-true-lender-legislation-didmca-opt-out-and-enhanced-federal-scrutiny/.

[11] Consumer Financial Services Law Monitor, Maryland is Latest State to Introduce Legislation Targeting Bank Partnership Programs (Jan. 12, 2024), available at https://www.consumerfinancialserviceslawmonitor.com/2024/01/maryland-is-latest-state-to-introduce-legislation-targeting-bank-partnership-programs/.

[12] 12 U.S.C. § 1831d(a).

[13] Relative parity between national banks and state banks has been a long-standing principle principle of our dual-banking system. *See, e.g., Tiffany v. National Bank*, 85 U.S. (18 Wall.) 409, 411 (1874); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 828 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993).

[14] 12 U.S.C. § 1831d(b).

[15] H.R. 4439, 115th Cong. § 2(3) (2017).

[16] Julapa Jagtiani & Catharine Lemieux, Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?, 87 J. Econ. Bus. 43 (2016), available at https://www.philadelphiafed.org/consumer-finance/consumer-credit/do-fintech-lenders-penetrate-areas-that-are-underserved-by-traditional-banks.

[17] Federal Reserve Bank of Philadelphia, The Role of Bank-Fintech Partnerships in Creating a More Competitive and Inclusive Financial System (2023), available at https://www.philadelphiafed.org/the-economy/banking-and-financial-markets/the-role-of-bank-fintech-partnerships-in-creating-a-more-inclusive-banking-system.

[18] H.R. 4439, 115th Cong. § 2(4)-(5) (2017).

[19] H.R. 4439, 115th Cong. § 2(5) (2017).

[20] *See Tiffany, supra.*
[21] *Marquette, supra, at* 308-310. The Court recognized borrowers' freedom of movement and their freedom of choice among lenders. *Id.* at 310-311. The Court also recognized that a more fragmented transactional analysis would "throw into confusion the complex system of modern interstate banking." *Id.* at 312.
[22] H.R. 4439, 115th Cong. §§ 3-4 (2017).
[23] Federal Reserve, FDIC, and OCC, Interagency Guidance on Third-Party Relationships: Risk Management (June 2023), available at https://www.federalregister.gov/documents/2023/06/09/2023-12340/interagency-guidance-on-third-party-relationships-risk-management.
[24] See supra note 7.
[25] Business Law Today, Colorado DIDMCA Opt-Out Litigation: District Court Grants Preliminary Injunction (July 12, 2024), available at https://businesslawtoday.org/2024/07/colorado-didmca-opt-out-litigation-district-court-grants-preliminary-injunction/.
[26] American Fintech Council, Federal: AFC Letter to House Financial Services Committee on Principles to Make Community Banking Great Again (Dec. 2024), available at https://www.fintechcouncil.org/advocacy/federal-afc-letter-to-house-financial-services-committee-on-principles-to-make-community-banking-great-again.