Client Alert

Current Issues Relevant to Our Clients

November 9, 2015

Maryland Court Decision Could Affect Consumer Marketplace Lenders

A recent decision of the Maryland Court of Special Appeals could impact marketplace and other lenders who arrange for federal or state banks to fund consumer loans in Maryland at rates in excess of the applicable Maryland usury caps. Along with the May 2015 decision of the U.S. Court of Appeals for the Second Circuit in Madden v. Midland Funding,[1] *the decision could call into question the ability of consumer lenders to rely upon bank funding arrangements to establish usury law exemptions in certain states.*

The Maryland decision, *Maryland Commissioner of Financial Regulation v. CashCall, Inc., et al* (filed October 27, 2015), concerned sanctions imposed by the Maryland Commissioner of Financial Regulation (the "*Commissioner*") on CashCall, Inc., a California-based payday lender. CashCall maintained a website through which consumers could apply for loans. CashCall had entered into contractual arrangements with two federally-insured state banks (the "*Funding Banks*") pursuant to which CashCall would forward each completed loan application to one of the Funding Banks for its review. If the Funding Bank approved a loan application, it would disburse the loan proceeds directly to the consumer, net of an origination fee, and then sell the loan to CashCall not later than the third day following the funding date. The Bank also would pay CashCall in connection with each funded loan a "royalty fee" equal to a portion of the related origination fee. The interest rates on the loans substantially exceeded the rates generally allowed on consumer loans under Maryland law.[2] The Funding Banks had not violated Maryland law in extending the loans because, under federal law, federally-insured depository institutions may charge the interest rates permitted by their home states on consumer loans regardless of the borrower's actual location. The Commissioner nonetheless found that in arranging the loans, CashCall had violated the Maryland Credit Services Business Act (the "*Credit Services Act*") which, in relevant part, prohibits any person engaged in a "credit services business" from assisting consumers to obtain loans at interest rates which, except for federal preemption of state law, would be prohibited under Maryland law. The Commissioner found that CashCall had arranged more than 5,000 loans in Maryland in violation of the Credit Services Act and imposed on CashCall a penalty of $1,000 per loan, resulting in a total civil penalty of $5,651,000.

CashCall argued on appeal that it was not engaged in a "credit services business" and therefore had not violated Maryland law.[3] The Credit Services Act defines a "credit services business" as one in which a person obtains or assists a consumer in obtaining an extension of credit "in return for the payment of money or other valuable consideration". In an earlier decision, the Maryland Court of Appeals (the highest court in Maryland) had held that under the quoted language a business is a "credit services business" only if the payment it receives for arranging an extension of credit comes "***directly*** from ***the consumer."*** *Gomez v. Jackson Hewitt, Inc.,* 427 Md. 128 (2012). CashCall argued that as it did not receive any origination fees from its borrowers, but only royalty fees paid by the Funding Banks, it had not received any payments "directly from the consumer" and therefore was not subject to the Credit Services Act. The court hearing the CashCall case – the Maryland Court of Special Appeals – is an intermediate-level appellate court and therefore was required to apply the Court of Appeals' analysis in *Gomez*. The court concluded, however, that for two reasons *Gomez* did not support CashCall's position and it upheld the sanctions. First, the court concluded that the Court of Appeals intended the direct payment requirement only to apply to companies that are primarily engaged in providing goods or services to consumers other than arranging extensions of credit and not "to a company, like CashCall, which is exclusively engaged in assisting Maryland consumers to obtain small loans bearing [usurious] interest rates."[4] Second, the court found that even if the direct payment requirement does apply to businesses such as CashCall, the requirement had been satisfied because CashCall, as the purchaser of each funded loan from the Funding Banks, would receive payment from the consumer of the origination fee that is "rolled" into the principal amount of each loan. The court stated that the Maryland legislature had intended the Credit Services Act to prohibit payday lenders from partnering with non-Maryland banks to extend loans at rates exceeding the Maryland usury caps and that it would undercut the purpose of the legislation to limit its application to loan marketers who receive "direct payments" from the borrowers beyond the payments made on the loan.

It is not known at this time whether CashCall will appeal the decision to the Maryland Court of Appeals.[5] In the meantime, the decision of the Court of Special Appeals creates a significant issue for any marketplace lenders who partner with non-Maryland banks to offer consumer loans at interest rates exceeding the applicable usury caps. It is true that the legislative history discussed by the Court of Special Appeals indicates that the Maryland legislature principally intended the relevant provisions of the Credit Services Act to address abusive practices by payday lenders. Maryland regulators therefore may have less interest in applying the Act to marketplace lenders who arrange loans at much lower rates. The statutory language, however, does not distinguish between payday and marketplace lenders and potentially exposes to civil and/or criminal penalties any marketer who arranges loans at rates exceeding the usury caps.

In contrast to *Madden,* the Maryland decision does not hold that bank loans made to Maryland consumers at interest rates exceeding the usury caps will become unenforceable in whole or in part if sold to non-bank purchasers. The decision therefore does not appear to cast doubt on the ability of loan purchasers (including securitization trusts) to enforce any Maryland loans previously purchased by them.

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1 *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). The *Madden* decision is discussed in our Client Alerts dated June 3, 2015 and August 13, 2015.

2 The maximum per annum interest rate permitted by Maryland law on consumer loans is 33% for loans of $2,000 or less and 24% for loans greater than $2,000. Md. Com. Law § 12-306(a)(6).

3 CashCall filed its appeal of the Commissioner's sanctions in the Circuit Court for Baltimore City. The Circuit Court agreed with CashCall and reversed the Commissioner's order. The Commissioner then appealed the Circuit Court decision to the Court of Special Appeals, resulting in the decision discussed herein.

4 The *Gomez* case involved a tax preparation firm that assisted interested clients in obtaining refund anticipation loans ("*RALs*") by helping them to file RAL applications with a California bank. The clients did not pay the tax preparation firm any fees specifically related to the RALs but the bank made certain fixed and variable payments to the firm for the client referrals. The Court of Appeals held that the Credit Services Act was intended by the Maryland legislature to address abuses by "credit repair agencies" and payday lenders and should not be extended to the tax preparation firm since it primarily was engaged in providing services to its clients unrelated to any extension of credit (i.e., the preparation of their tax returns) and the clients did not directly compensate it for helping to arrange the RALs.

5 CashCall does not have an automatic right of appeal to the Court of Appeals. It may petition the Court of Appeals to hear an appeal and the Court of Appeals, in its discretion, may take the appeal or not.

For More Information

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