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Chapman Client Alert

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New Maryland Court Decision: Potential Impact on Consumer Marketplace Lenders

A recent decision of the Maryland Court of Appeals (the highest court in Maryland) could require marketplace lenders and others who arrange for federal or state banks to fund consumer loans to consumers residing in Maryland to obtain licenses as "credit services businesses" and, of perhaps greater importance, could prohibit them from arranging those loans at interest rates exceeding the applicable Maryland usury caps. The decision therefore could reduce the volume of loans which certain marketplace lenders and loan marketers will be permitted to arrange in Maryland.

The Maryland decision, *CashCall, Inc. and J. Paul Reddam v. Maryland Commissioner of Financial Regulation* (filed June 23, 2016), concerned sanctions imposed by the Maryland Commissioner of Financial Regulation (the *"Commissioner"*) on CashCall, Inc., a California-based payday lender (*"CashCall"*). 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 Funding 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.[1] 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.[2] 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 Court of Appeals 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, 154 (2012) (emphasis added). CashCall argued that as it did not receive any origination fees from the 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 rejected CashCall's argument and upheld the sanctions imposed by the Commissioner. The Court held that CashCall was not entitled to rely upon *Gomez*, and clarified the scope of that decision by stating that the direct payment requirement only applies to companies that are primarily engaged in providing goods or services to consumers other than arranging extensions of credit and does not extend "to a company, like CashCall, which is exclusively engaged in assisting Maryland consumers to obtain small loans bearing [usurious] interest rates."[4] The Court further 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.[5] In fact, said the Court, CashCall's activities were exactly what the Maryland legislature intended the Credit Services Act to prohibit.

The Court did acknowledge that the Credit Services Act only applies to loan marketers who provide their services "in return for the payment of money or other valuable consideration." In this regard, the Court held that CashCall's right to receive principal, interest and fees on the loans it purchased from the

Funding Banks constituted adequate "consideration" for purposes of the statute. In fact, said the Court, the overall arrangements between CashCall and the Funding Banks (under which the latter retained no economic interest in the loans) appeared to constitute a "rent-a-bank scheme" that "rendered CashCall the *de facto* lender." This latter statement is interesting to the extent it suggests that the Maryland courts may be willing, at least in some circumstances, to apply the "true lender" doctrine to loan marketers if the originating bank has no continuing economic interest in the loans.[6]

The Court's decision potentially creates significant issues for marketplace lenders who partner with non-Maryland banks to offer consumer loans to Maryland consumers. First, the decision impacts licensing. The import of the decision is that a non-bank marketplace lender may need to have a credit services business license in order to market loans originated by a financial institution. The decision may also indicate that marketplace lenders need to adhere to the substantive provisions of the Credit Services Act, including the prohibition on soliciting Maryland residents for loans at interest rates exceeding the applicable usury caps permitted under Maryland law. It is true that the legislative history discussed by the Court 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. A marketplace lender (other than a balance sheet lender) might also distinguish its practices from those of CashCall by noting that it typically will sell the loans it purchases from the originating banks to third-party investors and therefore will not receive ongoing payments on the loans for its own account. 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 consumer loans (i) without being licensed as a "credit services business," or (ii) at rates exceeding the usury caps.

The Court of Appeals did not hold that bank loans arranged by unlicensed credit services businesses or at interest rates exceeding the usury caps are unenforceable (either in whole or in part). In fact, the decision states that loans made by out-of-state banks at rates permissible for that bank are valid. The decision therefore does not appear to cast doubt on the ability of loan purchasers (including securitization trusts) to enforce any Maryland loans purchased by them. However, the decision has implications for entities marketing loans that are not licensed and/or who solicit loans for others in excess of Maryland permissible rates.

For More Information

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1 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).

2 Credit services businesses also must obtain licenses from the Maryland Department of Labor, Licensing and Regulation.

3 CashCall originally 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 Maryland Court of Special Appeals, which reversed the Circuit Court and upheld the sanctions. *Maryland Comm'r of Fin. Regulation v. CashCall, Inc., et al,* 225 Md. App. 313, 124 A.3d 670 (2015). We discussed the Court of Special Appeals' decision in our Client Alert dated November 9, 2015. http://www.chapman.com/insights-publications-Maryland_Court_Consumer_Marketplace_Lenders.html. The Court of Appeals subsequently agreed to hear CashCall's appeal from the decision of 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 The Court nonetheless stated that if the direct payment requirement *did* apply to companies 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 together with the interest payments and (potentially) late fees due on the loan.

6 Under the "true lender" doctrine, courts may examine the facts and circumstances surrounding loan marketing programs to determine whether, for regulatory purposes, the non-bank loan marketer rather than the bank which funds the loans should be treated as the actual lender. Among other matters, the court will consider the extent of the bank's economic interest in the loans and its involvement in setting the underwriting criteria and vetting prospective borrowers. If the loan marketer, rather than the bank, is deemed to be the "true lender," the marketer will not be entitled to rely upon federal preemption of state law to establish exemptions from state consumer lender licensing requirements or state usury limits. The "true lender" doctrine is discussed in greater detail in our Client Alert dated February 1, 2016. http://www.chapman.com/insights-publications-Federal_Court_True_Lender_Doctrine_Internet_Lender.html.

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