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U.S. Regulatory Landscape: Fintech Product Overview

Amidst an ever-changing U.S. regulatory landscape, Israeli fintechs need to carefully consider their licensing obligations when offering their products to U.S. consumers.

Israeli fintech companies offering financial products to U.S.-based consumers must be very mindful of the regulatory considerations associated with the credit products they plan to offer. A "consumer" means a natural person to whom "consumer credit" is offered or extended. Consumer credit typically means credit offered or extended to a consumer primarily for personal, family or household purposes. Credit extended to a legal entity, such as a trust or a company, generally falls outside of the definition of consumer credit. In consumer financial services, a consumer is a natural, individual borrower who plans to obtain credit for a personal as opposed to a commercial or business purpose.

Heightened regulatory considerations arise when any fintech company—Israeli or domestic—offers consumer financial products through a "marketplace lending" arrangement. Marketplace lending is the practice of pairing borrowers and lenders through the use of an online platform without a traditional bank intermediary. The business model used by the companies determines the precise regulatory issues and the extent of such issues. The predominant model involves an arrangement where a fintech partners with a bank. Under this model, the fintech finds consumers interested in obtaining financial products offered by the bank. Consumers apply for the products offered by the bank. If approved, the bank provides the product to the consumers. At some point after the bank provides the product to the consumers, the fintech buys either a loan participation or the whole loan from the bank. The fintech also services the products on the bank's behalf.

The regulatory issues posed by this arrangement depend on exactly which services the fintech performs for the bank in the marketplace lending structure. The traditional model where the fintech finds the consumers, the bank funds the product and the fintech services the product raises licensing issues centered around whether the fintech triggers broker, servicing and debt collection licensing requirements. Several states also require specific licenses to take assignment of loans. Due to regulatory scrutiny of marketplace lending arrangements, some fintechs merely service the products offered by the bank. A completely different set of regulatory issues arise in this scenario. Only servicing and debt collection related licensing issues arise.

In addition to licensing related issues, multiple regulators regulate marketplace lending arrangements. The regulator governing a particular consumer financial product to U.S.-based consumers depends on whether the company offering such products is a credit union, bank or nonbank. The type of legal entity determines both licensing and usury related regulatory issues.

U.S. FINANCIAL SERVICES REGULATORS

Multiple federal and state regulators regulate marketplace lending arrangements. The financial institution involved in the marketplace lending arrangement will be either a credit union or bank. Fintechs rely on the credit union or bank's ability to make loans under one uniform set of laws and to export interest rates from their home jurisdictions across the United States. To leverage interest rate exportation, such institutions must decide to obtain a charter (i.e., effectively become licensed) under federal or state statutes.

A credit union is a nonprofit financial institution that accepts deposits, makes loans and provides a wide array of other financial services and products. The National Credit Union Share Insurance Fund insures all consumer deposits. The National Credit Union Administration (NCUA) manages the insurance fund. NCUA also charters and supervises federal credit unions. State regulators such as the New York State Department of Financial Services and the California Department of Financial Protection and Innovation regulate state-chartered credit unions.

Banks can be chartered by the Office of the Comptroller of the Currency (OCC) or by a state regulatory body. The OCC is an independent bureau of the U.S. Department of the Treasury. The OCC charters, regulates and supervises national banks, federal savings associations and federal branches and agencies of foreign banks. State regulators such as the Utah Department of Financial Institutions (DFI), Texas Department of Banking and the Illinois Department of Financial and Professional Regulation, Division of Banking regulate banks chartered in each of these states. The entity must pick which regulatory body will regulate its activities. This can be a tricky proposition. Each regulatory body has its own pluses and minuses. Entities typically pick the regulator and statutes most favorable to the products they plan to offer. For consumer lenders, many entities choose to become Utah state-chartered banks due to the favorable lending statutes. The DFI charters, regulates, supervises and examines Utah state-chartered financial institutions.

State-chartered banks also may join the Federal Reserve System. The Federal Reserve regulates financial holding companies in addition to savings and loan holding companies and financial market utilities.

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The Federal Deposit Insurance Corporation is the primary regulator for state-chartered banks that do not join the Federal Reserve System.

Separate federal regulators regulate a financial institution's compliance with federal consumer protection statutes. The Consumer Financial Protection Bureau (CFPB) separately regulates certain financial institutions for compliance with federal consumer protection statutes and regulations. The CFPB generally regulates banks and credit unions with assets over $10 billion and their affiliates. In late April 2022, the CFPB previously announced that it was "invoking a largely unused legal provision to examine nonbank financial companies that pose risks to consumers." CFPB Press Release, April 25, 2022. Under the Dodd-Frank Act, the CFPB already had broad supervisory authority over all nonbank entities in the mortgage, private student loan, and payday loan industries regardless of size and nonbanks that are determined by regulation to be "larger participants."

Larger participants include consumer reporting, debt collection, student loan servicing, international remittances and auto loan servicing. This authority has not been used before. The announcement seems to target fintech companies as the CFPB stated that this will allow it to supervise entities that are fast-growing or in markets outside the bureau's existing supervision programs. In essence, any nonbank not currently supervised will be subject to this unspecific and uncertain rule. Critics see this as a return to the mantra of "regulation by enforcement" rather than regulation, given the lack of guidelines the CFPB must follow in assessing risk to consumers or engaging in supervisory activity. While the bureau sees this as leveling the playing field with banks, it proposes to make its actions public, whereas this is not the case with much of the supervisory activities of depository institutions. At least in the short term, fintechs should expect closer scrutiny, examination and enforcement from the CFPB.

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The Federal Trade Commission (FTC) regulates nonbanks' compliance with certain consumer protection statutes. The FTC regulates nonbank financial services providers with regard to deceptive or unfair business practices and from unfair methods of competition through law enforcement, advocacy, research and education. The FTC does not have supervisory or enforcement authority over banks and credit unions.

In many instances, the same regulator regulating state-charted banks regulates nonbank fintechs. The DFI follows this path. In addition to Utah state-chartered banks, the DFI regulates nonbank mortgage servicers, consumer lenders and money services businesses. The New Jersey Division of Banking also regulates nonbank entities offering financial products to consumers. These regulators also may impose regulatory requirements on loan servicing and debt collection activities. State regulation typically includes: (i) licensing; (ii) disclosures; (iii) interest rates; and (iv) fees. The states may require licenses to make unsecured consumer loans in addition to arrange loans, service loans, engage in debt collection activities or take assignment of the loans. Not every state requires a license for every type of activity. For instance, Florida requires a Consumer Finance Company license to make unsecured loans. However, Florida does not require a broker license to arrange such loans, a loan servicing license or a debt collection license.

State attorneys general also have enforcement authority over financial service providers for violations of state consumer protection statutes and regulations.

STATE REGULATORY CONSIDERATIONS

Broker Licensing

Depending on the specifics of the marketplace lending model used, a state may require the fintech to obtain a license to arrange (i.e., broker) loans for another lender. The state statutes vary in terms of licensing triggers. For instance, Nevada requires an entity to obtain a license to "engage in the business of lending" in Nevada. NEV. REV. STAT. ANN. § 675.060. Engaging in the business of lending in Nevada includes each of the following: (i) soliciting loans in Nevada, making loans in Nevada or making loans to Nevada residents, unless such transactions are isolated, incidental or occasional; or (ii) being physically present in Nevada and soliciting loans from consumers located in other states or making loans to consumers located in other states, unless such transactions are isolated, incidental or occasional. NEV. REV. STAT. ANN. § 675.020(4). Nevada also requires a license when a fintech "holds, acquires or maintains a material economic interest in the revenues generated by the loan" that is funded by a bank (i.e., an exempt entity). NEV. REV. STAT. ANN. § 675.035(3)(c). The Nevada statute does not define what a material economic interest means. The Nevada regulator reads these statutory provisions as requiring a license for any fintech finding potential consumers interested in financial products issued by a bank.

While solicitation is the primary trigger for a

Nevada license, other states focus on arranging loans for others. A license is required in Tennessee to engage in the business of an industrial loan and thrift company. TENN. CODE ANN. § 45-5-103(a). The definition of industrial loan and thrift company includes an endorsement company. An endorsement company is engaged in the business of arranging a loan for a fee. TENN. CODE ANN. 0§ 45-5-102(8), (11). In Hawaii, an installment loan license is required to: (i) offer or make consumer loans; (ii) arrange a consumer loan for a third party; or (iii) act as an agent for a third party regardless of whether: (a) the third party is exempt from licensure; or (b) approval, acceptance or ratification by the third party is necessary to create a legal obligation for the third party through any method including mail, telephone, the internet or any electronic means. HAW. REV. STAT. §§ 480J-31(a), 480J-1, 480J-2(a)(2).

Other states require a license based on the totality of the circumstances. In Maine, a fintech must obtain a Supervised Lender License when acting as an agent, service provider or in another capacity for an exempt institution (i.e., bank) when: (i) the fintech holds, acquires, or maintains the predominant economic interest in the loan; (ii) the fintech markets, brokers, arranges, or facilitates the loan and holds the right of refusal to purchase loans, receivables or interests in the loans; or (iii) the "totality of the circumstances" indicate that the fintech is the lender and the transaction is structured to evade Maine statutes. ME. REV. STAT. ANN. tit. 9-A, § 2-702(1)–(3).

Maine looks at the following factors to ascertain whether the "totality of the circumstances" indicate that the fintech is the lender: (i) the fintech indemnifies, insures, or protects an exempt entity for any loan related costs or losses; (ii) the fintech predominantly designs, controls or operates the loan program; or (ii) the fintech purports to act as an agent, service provider or in another capacity for an exempt entity while acting as a lender in other states. ME. REV. STAT. ANN. tit. 9-A, § 2-702(3)(A)–(C).

Illinois similarly measures the totality of the circumstances by looking at whether the fintech: (i) indemnifies, insures or protects an exempt entity for any loan related costs or losses; (ii) predominantly designs, controls or operates the loan program; or (iii) purports to act as an agent, service provider or in another capacity for an exempt entity while acting as a lender in other states. 815 ILL. COMP. STAT. ANN. § 123/15-5-15(b)(3)(i)-(iii)

Servicing and Debt Collection Licensing

The fintech typically services the loan in a marketplace lending arrangement. Collecting periodic payments from the consumers raises licensing issues. Many states require loan servicers and debt collectors to obtain licenses to perform their contractual obligations in a marketplace lending arrangement.

Texas requires a license to "contract for, charge, or receive, directly or indirectly" interest or fees in connection with a loan with an interest rate exceeding ten percent on an annual basis. TEX. FIN. CODE ANN. § 342.051(a)(2). Any fintech receiving interest and fees directly or indirectly from a consumer due and owing to a bank or lender must obtain a license to service loans made pursuant to a marketplace lending arrangement. Nebraska requires a license to hold or acquire loan serving rights or any other form of loan participation. NEB. REV. STAT. ANN. §§ 45-1005, 45-1004(1)(b). The license allows a servicer to charge, contract for and receive the maximum amount allowed for interest and charges under the Nebraska Installment Loan Act. NEB. REV. STAT. ANN. § 45-1004(1)(a). Georgia requires a license to engage in the business of acting as an "installment lender." GA. CODE ANN. § 7-3-4(a). Georgia defines an installment lender in a manner that includes servicing loans of $3,000 or less made by others, excluding loans made by affiliated entities. GA. CODE ANN. § 7-3-3(6)-(7).

While other states have similar loan servicing licensing requirements, states also require a license to engage in debt collection. In the context of a marketplace lending arrangement, debt collection occurs when the fintech collects payments for a bank or lender that owns the underlying loan. California and Hawaii illustrate this point. The Debt Collection Licensing Act requires a license to engage in the business of "debt collection" in California. CAL. FIN. CODE § 100001(a). Debt collection includes any act or practice used in connection with the collection of "consumer debt." CAL. FIN. CODE § 100002(i). "Consumer debt" means money due or owing or alleged to be due or owing from a natural person resulting from a "consumer credit transaction." CAL. FIN. CODE § 100001(f). Under the statute, a consumer credit

transaction means a transaction in which property, services or money is acquired on credit by a natural person primarily for personal, family or household purposes. CAL. FIN. CODE § 10001(e). The term "debt collector" means any entity regularly engaging in debt collection on its own behalf or behalf of others. CAL. FIN. CODE § 100002(j).

Hawaii requires a collection agency collecting or attempting to collect any money or any other forms of indebtedness alleged to be due and owing from any consumer residing in Hawaii without first registering. HAW. REV. STAT. § 443B-3(a).

Taking Assignment of Loans Licensing

A license also may be required to take assignment of a consumer loan. Many of these statutes require a license when the fintech takes assignment of the loan and undertakes direct collection of payments due and owing from the consumer. Wyoming illustrates this point. In Wyoming, a nonexempt entity must not engage in the business of taking assignments of non-servicing rights relating to consumers loans that are not in default without a license. WYO. STAT. ANN. § 40-14-302(b).

Many states have licensing requirements triggered simply by engaging in activities in that state.

Idaho, Louisiana, and Colorado also illustrate this point. Unless exempt, Idaho requires a license to engage in the business of taking assignment of and undertaking direct collection of payments from or enforcement of rights against debtors arising from regulated consumer loans. IDAHO CODE § 28-46-301(1). Louisiana similarly requires a license to take assignment of and undertake direct collection of payments from or enforce rights against consumers arising from consumer loans. LA. REV. STAT. ANN. § 9:3557. Assignees engaged in direct collection of loans require a Colorado supervised lender license if the loan is under $75,000 with an interest rate exceeding twelve percent. COLO. REV. STAT. ANN. §§ 5-1-301(15)(a), 5-1-301(46)-(47).

Massachusetts is unique in the sense that it potentially requires a fintech to obtain both servicing and debt collection licenses. Massachusetts requires a "third-party loan servicer" to register (i.e., become licensed) with the Division of Banks. MASS. GEN. LAWS ANN. ch. 93, § 24A(b). The definition of third-party loan servicer means any entity that uses an instrumentality of interstate commerce or the mail in any business the principal purpose of which is "servicing" a loan directly or indirectly owned or due or asserted to be owed or due another. MASS. GEN. LAWS ANN. ch. 93, § 24. "Servicing" means receiving a scheduled periodic payment from a consumer pursuant to the loan's terms and making the payments to the owner of the loan or other third party of principal and interest and other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the servicing loan document or servicing contract. MASS. GEN. LAWS ANN. ch. 93, § 24.

Massachusetts also requires licensing for a "debt collector" or any entity engaging in soliciting the right to collect or receive payment for another of an account, bill or other indebtedness. MASS. GEN. LAWS ANN. ch. 93, §24A(a). The definition of debt collector includes any entity that uses an instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of a debt or that regularly collects or attempts to collect, directly or indirectly, a debt owed or due or asserted to be owed or due another. MASS. GEN. LAWS ANN. ch. 93, § 24. However, the definition of debt collector does not include an entity that collects a debt that was not in default of the time it was originally obtained for collection. MASS. GEN. LAWS ANN. ch. 93, § 24.

Avoiding Licensing Triggers

Many states have licensing requirements triggered simply by engaging in activities in that state. Nevada illustrates this point. A license is required for helping Nevada consumers obtain a loan from a bank or lender. In other states, fintechs can avoid triggering licensing requirements by refraining from certain types of loans. A state's licensing trigger often relates to loan amounts and

either the loan's interest rate or annual percentage rate.

Massachusetts illustrates this point. A broker license is required for loans of $6,000 or less with interest rates exceeding twelve percent. MASS. GEN. LAWS ANN. ch. 140, § 96. A license is required for any person, directly or indirectly, engaging, for a fee, commission, bonus or other consideration in the business of negotiating, arranging, aiding or assisting the borrower or lender in procuring or making loans of $6,000 and carry an annual percentage rate of twelve percent or more. MASS. GEN. LAWS ch. 140, § 96.

In New Hampshire, a license is required to broker or service a loan of $10,000 or less with an annual percentage rate of ten percent or more. N.H. REV. STAT. ANN. §§ 399-A:2(I), 399-A:1(XX). Licensing is required for any entity that for compensation or gain or in expectation of compensation or gain, either directly or indirectly: (i) acts as an intermediary, finder or agent of the lender or borrower for the purpose of negotiating, arranging, finding or procuring loans or loan commitments; (ii) offers to serve as an agent for a lender; (iii) performs services or any of the business functions auxiliary or supplemental to the production, distribution or maintenance of loans for a lender; and (iv) holds the servicing rights to a small loan. N.H. REV. STAT. ANN. § 399-A:1(XX)(a)-(b), (d), (g).

Fintechs can avoid Massachusetts licensing requirements by keeping the annual percentage rate below twelve percent. Alternatively, loans above $6,000 do not trigger a licensing obligation in Massachusetts. A license requirement similarly is not triggered in New Hampshire if the loan contains an annual percentage rate less than ten percent or the loan exceeds $10,000.

CONCLUSION

In light of an ever-changing regulatory landscape, fintechs need to carefully consider what licensing obligations may be triggered by their business arrangements. Because complying with licensing requirements is complex and ever changing, fintechs should review industry releases and state enforcement actions to keep abreast of licensing considerations. ■

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In emerging technologies, Tobias has extensive experience helping fintechs, marketplace lenders, mortgage fintechs, and online and small dollar lenders establish compliance management systems and address regulatory issues impacting design and delivery of new financial services products. With respect to compliance programs, Tobias advises on building, reviewing, and auditing compliance management systems to minimize risks associated with various consumer and commercial financial products.

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