OCC Issues Proposed "True Lender" Rule

July 28, 2020

On July 20, 2020, the Office of Comptroller of the Currency (the "OCC") issued a notice of proposed rulemaking ("NPR") that would establish when a national bank or federal savings association (collectively referred to herein as "bank"), in the context of a partnership between the bank and a third party, is the "true lender" when making a loan.[1] Under the proposed rule, as described further below, a bank is a "true lender" if, as of the date of origination, it is either: (1) named as the lender in the loan agreement or (2) funds the loan. Comments on the proposed rule are due on or before September 3, 2020.

The NPR is another demonstration of the OCC's continued effort to provide legal certainty and support to national banks and their partnerships with Fintech and other third parties.[2] This NPR comes less than two months after the OCC published a recently codified final rule confirming that interest rates that are permissible for a national bank before transfer of a loan continue to be permissible after the transfer of the loan to a nonbank Fintech or other counterparty (commonly known as the "valid when made doctrine").[3] The Federal Deposit Insurance Corporation (the "FDIC") recently published a similar final rule affirming the valid when made doctrine for state banks,[4] and has indicated it will address the "true lender" doctrine in future rulemaking.[5] If the FDIC follows the OCC's approach, national and state banks would have important issues relating to partnership with Fintech addressed. These banking agency actions and statements evidence a heightened focus on strengthening the symbiotic relationship

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1 OCC, National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44223 (July 22, 2020).

2 The OCC has recently issued an advance notice of proposed rulemaking ("ANPR") inviting public comment on its regulations broadly relating to the "digital activities" of national banks and federal savings associations. For a Debevoise update on this ANPR, see here.

3 12 C.F.R. § 7.4001 and § 160.110. OCC, Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 33530 (June 2, 2020). For a Debevoise update on this final rule and the valid when made doctrine, see here.

4 FDIC, Federal Interest Rate Authority, 85 Fed. Reg. 44146 (July 22, 2020).

5 FDIC, Statement by FDIC Chairman Jelena McWilliams on the Final Rule: Federal Interest Rate Authority, June 25, 2020, found here.

between banks and Fintech by clarifying and solidifying the legal framework for their credit arrangements.[6]

This client update focuses on the proposed rule. In his statement upon appointment, Brian Brooks, the newly appointed Acting Comptroller of the Currency, promised to provide clarity on these issues, saying "As the administrator of the federal banking system we have a responsibility to defend the authority and the powers Congress granted that enable the federal banking system to evolve, to harness the power of rapidly changing technologies and financial markets, to support a nationwide economy, and to serve local needs."[7] Given the potential size of the symbiotic relationship between bank loan sellers and Fintech purchasers, the outcome of this rulemaking is very important to the continued evolution of banking and Fintech.

History, Rationale and Substance of Proposal

History

Federal law, under provisions of the National Bank Act (the "NBA"), the Federal Reserve Act and the Home Owners' Loan Act (the "HOLA")[8], authorizes banks to enter into contracts, to make loans and to subsequently transfer those loans and assign loan contracts. These statutes, however, do not address which entity is to be deemed to have made a loan, or as referred to in case law, which entity is the "true lender," in the context of a lending arrangement between a bank and a third party. The determination of who is the "true lender" in these contexts will determine key aspects of the legal framework applicable to the loan, including the applicability of state interest rate caps.

In light of the ambiguity in these statutes, courts have developed divergent standards for resolving the "true lender" question. Some courts have concluded that the form of the transaction alone is dispositive, while others have applied what the OCC describes as "fact-intensive balancing tests" involving "a multitude of factors" aimed at determining who has the predominant economic interest in the transaction.[9] The OCC asserts that these fact-intensive inquiries and the lack of a uniform and predictable standard make

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6 The FDIC'S Brokered Deposit Proposal, found here, seeks to provide greater clarity as to their deposit arrangements.

7 OCC, Brian P. Brooks Statement on Becoming Acting Comptroller, May 29, 2020, found here.

8 12 U.S.C. 24, 1464(c) and 371, respectively.

9 *See e.g., Beechum v. Navient Solutions, Inc.* (No. EDCV 15-8239-JGB-KKx, 2016 WL 5340454 (C.D. Cal. Sept. 20, 2016)) (holding that the court will look "only to the face of the transactions at issue") and *CFPB v. CashCall, Inc.* (No. CV 15-7522-JFW, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016)) (examining "which party or entity has the predominant economic interest in the transaction," including by evaluating which party placed its money at risk).

the "true lender" determination increasingly subjective, thereby increasing legal uncertainty and undermining banks' ability to partner with third parties.[10]

General Rationale

The OCC offers a number of arguments in support of the proposed rule. The OCC asserts it has the authority to interpret and resolve statutory ambiguities in the federal banking laws it is charged with administering and to ensure clarity and uniformity for the banks it supervises. The proposed rule, the OCC asserts, would enable banks to fully exercise the lending authority granted to them under federal law and allow stakeholders to reliably and consistently identify key aspects of the legal framework applicable to a loan. The OCC also stresses the importance of these lending relationships with third parties in allowing banks to manage their risk and leverage their balance sheets to increase the supply of available credit. These partnerships may also enable banks to market affordable loan products to a wider range of potential customers.

The NPR also emphasizes the heightened regulatory and supervisory consequences that flow from a determination that a bank is the "true lender." The OCC's focus on these consequences are likely aimed, at least in part, at assuaging concerns already expressed by consumer advocates and state banking regulators[11] that the proposed rule's new standard will harm consumers by encouraging predatory lending in the absence of state law protections. The OCC notes that banks would be fully responsible for consumer compliance, underwriting and fair lending with respect to these loans, including compliance with: the underwriting standards and loan documentation policies and procedures that the OCC expects all banks to establish and maintain; various federal consumer protection laws, such as federal Unfair, Deceptive, or Abusive Acts or Practices ("UDAAP") and fair lending laws; the requirement for banks engaged in lending to take into account the borrower's ability to repay the loan according to its terms;[12]and the OCC's list of lending practices that may be considered predatory, unfair, or deceptive. The OCC also stresses that the proposed rule would not relieve banks of their legal and risk management responsibilities in their relationships with bank partners, including those responsibilities detailed under the OCC's supervisory guidance on bank relationships with third party lenders and service providers.

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[10] OCC, National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44224.

[11] *See e.g.,* Conference of State Bank Supervisors, "Statement on the OCC's Proposed True Lender Rule" (July 20, 2020), found here.; National Consumer Law Center, "OCC Proposal Would Turn State Interest Rate Limits into a "Dead Letter," Causing Explosion of Rent-a-Bank Payday Lending That Will Devastate Struggling Families" (July 20, 2020), found here. The New York Department of Financial Services is also challenging the OCC Fintech charter in a case before the U.S. Court of Appeals for the Second Circuit. *See Lacewell v. Office of the Comptroller of the Currency,* 2d Cir., No. 19-04271 (July 23, 2020).

[12] *See* 12 CFR7.4008(b), 34.3(b), part 30, appendix A, §§ II.C.2 and II.D.3.

Proposed Framework and Justification of Components

In order to resolve the statutory ambiguity, the proposed rule would interpret the above statutes[13] to provide that a bank makes a loan whenever it, as of the date of origination, (1) is named as the lender in the loan agreement or (2) funds the loan. The OCC provided the following support for each basis:

- **Named in Loan Agreement.** The OCC states that if a bank is named in the loan agreement as the lender as of the date of origination, "the OCC views this imprimatur as conclusive evidence that the bank is exercising its authority to make loans pursuant to [the NBA/Federal Reserve Act or HOLA] and has elected to subject itself to the panoply of applicable Federal laws and regulations (including but not limited to consumer protection laws) governing lending by banks."

- **Funds the Loan.** The OCC states that this basis is intended to capture circumstances in which a bank is not named as the lender in the loan agreement but is still, in the OCC's view, making the loan. Under this funding standard, "if a bank funds a loan as of the date of origination, the OCC concludes that it has a predominant economic interest in the loan and, therefore, has made the loan—regardless of whether it is the named lender in the loan agreement as of the date of origination." This standard would eliminate the "unnecessarily complex and unpredictable" multifactor test that has been applied by some courts to determine which entity has a predominant economic interest in the loan. Of particular note, the determination of which entity made the loan under this standard "would be complete as of the date the loan is originated and would not change, even if the bank were to subsequently transfer the loan."[14]

The OCC invites comments on all aspects of the proposed rule including whether there are additional lending arrangements that should be captured by the OCC's standards and whether the proposed standards would capture lending arrangements that should be excluded.

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Please do not hesitate to contact us with any questions.

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[13] The proposed rule would also interpret 12 U.S.C. 85 and 1463(g), which govern interest permitted on bank loans. The proposed rule would not, however, affect the application of federal consumer financial laws.

[14] OCC, National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44225.

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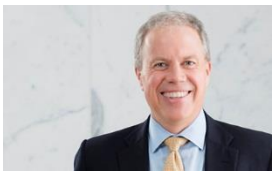
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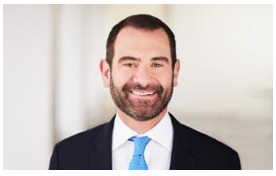
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