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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

OCC's 'True Lender' Plan Draws States' Ire, Industry Angst

By **Jon Hill**

Law360 (September 11, 2020, 11:35 PM EDT) -- The Office of the Comptroller of the Currency's draft "true lender" rule governing bank financing partnerships is likely to face challenges from states and consumer advocates if it advances as written, and it may also throw a wrench into financing arrangements used by car dealerships and mortgage lenders, according to experts and public feedback on the plan.

In comments made public over the past week, state attorneys general, consumer advocacy organizations, industry groups and others weighed in on the OCC's proposal to establish a simple test for determining who legally qualifies as the true lender when a federally chartered bank partners with a fintech firm or other nonbank for making loans, an issue that's repeatedly come up in litigation.

Under the proposed rule, the true lender in such a partnership would be considered the bank if it funds the loans or is named as the lender in the loan documents at origination. That "bright-line" standard stands in contrast to the complicated, fact-intensive analyses of nonbank partner involvement that courts have sometimes deployed when vetting the legality of loans made through these partnerships.

The OCC has said this simpler standard would go a long way toward reducing legal uncertainty that's faced these partnerships and supporting their innovative capacity, but reaction to the proposal suggests a tricky road ahead.

"There's no reason to believe that this rule won't be challenged by the same state attorneys general and others who have challenged the valid-when-made rule," said Jeffrey Taft, a partner in Mayer Brown LLP's financial services regulatory and enforcement group, referring to a recently completed OCC rule intended to quell doubts that have arisen about the enforceability of some interest rates on loans that nonbanks acquire from bank originators

The valid-when-made rule specifies that if the interest rate on a loan made by a federally chartered bank is valid at the time of origination, it will remain valid for the life of the loan, regardless of who might later purchase it. That rule could work in tandem with the true lender rule to provide a significant legal boost to the viability of bank-nonbank lending partnerships.

But such arrangements have been viewed with deep skepticism among consumer advocates, who see them as ripe for abuse by predatory lenders looking to evade state usury laws by tapping a bank partner's authority to charge higher interest rates.

Citing such concerns, a trio of Democratic state attorneys general sued to block the valid-when-made rule in July, arguing the OCC engaged in a flawed rulemaking process and overstepped its authority. They and a number of other state attorneys general have since moved to take on the Federal Deposit Insurance Corp. for issuing a similar rule, and in a Sept. 3 comment letter, an even larger coalition of 24 state attorneys general registered their "strong objections" to the true lender proposal.

"Under the guise of addressing 'uncertainty' regarding lending relationships between national banks and nonbanks, the proposed rule provides a veritable roadmap for structuring myriad rent-a-bank schemes that will be shielded from state scrutiny," the attorneys general wrote in a comment letter. "The states urge the OCC to withdraw the proposed rule in its entirety."

Previewing a potential court challenge, the attorneys general argued that the proposed rule suffers from a variety of defects that render it "arbitrary and capricious" and thus in violation of federal rulemaking standards, including that it attempts to preempt long-standing state-law true lender doctrines without adequate justification, abruptly abandons years of agency policy disfavoring the use of bank partnerships for high-cost lending, and "would not solve the problem it claims to remedy."

"The OCC argues that the proposed rule is designed to replace an unpredictable, subjective, and fact-intensive inquiry with a 'predictable, bright-line standard,' but the proposed rule will not accomplish this goal," the attorneys general wrote. "The proposed rule does not define what it means to 'fund' a loan, or address the likelihood that courts trying to make such a determination would conduct precisely the type of fact-intensive inquiries the proposed rule criticizes."

The attorneys general said the proposal also doesn't resolve who would be considered the true lender if one bank funds the loan but another bank is named on the loan documents, or why a loan's funding source is treated as dispositive of true lender status only when a bank is that funding source.

"The proposed rule is fundamentally flawed because its two categorical rules will produce contradictory and absurd results," the attorneys general wrote.

These criticisms of the true lender proposal were echoed in comment letters from a wide range of public interest groups and consumer advocates, including the Center for Responsible Lending, National Consumer Law Center, Better Markets and the National Community Reinvestment Coalition, as well as the Conference of State Bank Supervisors, which pointed to a **recent settlement** reached between Colorado and two online nonbank lenders as an example for the OCC to follow.

The settlement called for the online lenders and their bank partners to pay monetary relief, but it also laid out a way for the partnerships to continue operating in the state subject to a comprehensive set of bank oversight, pricing, disclosure, licensing and other standards.

"CSBS believes that the detailed and substantive 'safe harbor' approach resulting from this [Colorado] case represents the type of thoughtful and considerate balancing of competing policy priorities which is utterly lacking in the OCC's proposal," the state regulator organization wrote.

Not all the feedback submitted to the OCC was negative, of course. Many financial services companies and trade groups sent in letters applauding the agency for working to provide more certainty to bank-nonbank partnerships and their resulting loans.

"The Proposed Rule will bring much needed clarity to the marketplace without sacrificing consumer protections," the Consumer Bankers Association wrote in a Sept. 3 letter. "Most notably, the proposed rule would in no way relieve OCC-regulated banks of their existing legal and risk management responsibilities in their relationships with bank partners. ... CBA believes these requirements are strong and provide a structured regulatory scheme that provides for robust consumer protections."

But industry commenters did consistently express concerns about the need for further refinements to the proposal, with the American Bankers Association bluntly labeling the OCC's two-pronged standard as "overly broad."

"The proposed tests may inadvertently and detrimentally sweep in other traditional lending or finance arrangements such as mortgage warehouse lending, indirect automobile finance, loan syndication, and other structured finance," the nation's largest banking trade group wrote in a comment letter. "It is critical that the OCC identify precisely those financing arrangements to which the rule applies and the regulatory regimes for which the identification of a 'true lender' under the rule is applicable."

Kristi Leo, president of the Structured Finance Association, which submitted its own comment letter raising this point, explained that the issue stems from the lack of specificity in the proposal around what it means to "fund" a loan. In a situation where an independent mortgage originator is drawing on a bank's so-called warehouse line of credit, for example, the wording of the proposed rule leaves open the possibility that the warehouse bank could be deemed the true lender, despite it having next to no control over the loan origination process.

That, in turn, could lead to increased liability for the warehouse bank and throw off the economics of providing such financing facilities.

"The risk is that the banks are going to charge a lot more," Leo told Law360. "Having them be the originator of a loan brings additional responsibility and obligations, versus being just a financer of a loan."

That could mean higher costs for the consumers getting these mortgages, Leo said, and in some cases, banks may opt to simply drop out of the warehouse lending business altogether rather than take on the additional risk, which could wind up hurting credit availability.

Mortgage bankers have taken note. In a comment letter, their top trade group, the Mortgage Bankers Association, stressed that warehouse lenders should be excluded from the scope of the rule, arguing that their relationship with consumer-facing mortgage originators is very different from other bank-nonbank partnerships and risks being disrupted by the agency's proposal in its current form.

Other trade groups, like CBA and the American Financial Services Association, urged the OCC to make a similar exception for indirect auto lending, where car dealerships get backing from banks to provide financing to their customers. As written, it's unclear whether the rule applies to those banks, and that "could introduce uncertainty into the marketplace," AFSA wrote.

"I don't think that's at all what the OCC intended," Mayer Brown's Taft said. "I think it's just a real simple clarification that people are trying to get from the OCC to indicate that these types of common financing arrangements aren't what was intended to be considered funding a loan."

In a statement to Law360, an OCC spokesperson said the agency is now "reviewing the comments provided by stakeholders and considering any changes suggested to improve upon the proposal based upon that input."

"The agency appreciates all of the thoughtful comments that stakeholders provided," the spokesperson added.

--Editing by Aaron Pelc and Emily Kokoll.