

Insights

TRUE LENDER RULE: RETURN TO CONFUSION

Jul 28, 2021

The Short-Lived “True Lender” Rule

In October 2020, the Office of the Comptroller of the Currency (“OCC”) issued a final rule determining that a bank makes a loan, and is thus the “true lender,” where, as of the date of origination, that bank is “named as the lender in the loan agreement or funds the loan” (the “True Lender Rule”).^[1] As we discussed previously, the combination of the True Lender Rule with the “valid when made” doctrine allowed interest rates on bank-originated loans to remain valid even after a transfer of those loans to a non-bank partner.

Consumer advocates expressed concern that the True Lender Rule would allow predatory lenders to “get around state consumer protection laws.”¹ According to the OCC, the choice of law framework used to determine which state’s law applies to bank loans that was included in the final rule would “incorporate, rather than eliminate, state law.”² However, the True Lender Rule remained controversial. A recent article published by the Brookings Institution derided the True Lender Rule as “displacing state regulators and subjecting consumers to predatory loans”³ and the director of state policy at the Center for Responsible Lending called it “an existential threat to state interest rate limits that protect consumers from predatory lending.”⁴

Lawsuits by multiple states kept the rule from going into effect⁵ and, last month, President Biden signed a Congressional Review Act resolution nullifying the True Lender Rule.⁶

A Gap for Fintechs

Fintechs have often been looked to both as potentially providing hope for inclusionary access to finance, while also presenting serious challenges.⁷ Fintechs may use alternative algorithms for credit underwriting, or seek out other methods to serve underbanked communities. A study published by researchers from the Federal Reserve found that some borrowers who might be considered subprime using traditional criteria have more and lower-priced access to credit with lenders using alternative information sources.⁸

While both sides agree that access to credit can and should be improved, there is debate in weighing the appropriate mechanisms for doing so. Higher interest rates incentivize riskier lending, and may put a borrower on the hook for a payment they can't afford – but without being able to lend at a higher interest rate, there may be no lenders willing to extend credit to that borrower.

Future Landscape

We may see a return to earlier compromises, as in the August 2020 Colorado settlement with Avant of Colorado and Marlette Funding.⁹In that case, non-bank lenders Avant and Marlette partnered with out-of-state banks and made loans above Colorado's 36% consumer rate cap. Colorado alleged that (1) Avant and Marlette were prohibited from enforcing bank statutory interest rate exportation rights following assignment of bank loans,¹⁰and (2) Avant and Marlette were the true lenders because they had the "predominant economic interest" in the loans.¹¹Avant and Marlette disputed these allegations, instead arguing that the loans were (1) originated by state-chartered, federally insured banks and thus subject to federal preemption; (2) the bank partners were the true lenders; and (3) assignment of the loans did not affect the ability to enforce the loans on their original terms.¹²The settlement agreement includes \$1.5 million towards consumer protection and financial literacy efforts in Colorado and commitments not to lend to Colorado consumers at rates above 36%, to maintain Colorado lending licenses, and to provide certain protections to Colorado consumers to ensure true bank loans are being made.¹³

Alternatively, Congress may devise a nationwide legislative approach. In 2019, Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez proposed the "Loan Shark Prevention Act," which would have amended the Truth in Lending Act to cap all consumer interest rates at the lesser of 15% or the maximum interest rate in the state in which the consumer resides.¹⁴Though the proposal died in committee, there were impassioned appeals on both sides of the issue, with it being hailed as an opportunity to "close one of the principal finance-regulatory loopholes allowing unjust and destabilizing exploitation to pervade our financial system"¹⁵and lambasted as pushing the most desperate consumers "into the world of loan sharks and pawn shops and illegal lending."¹⁶

For the moment? With no True Lender Rule and no uniform application of true lender doctrine, fintechs will have to continue with the status quo: offering innovation while navigating an uneven patchwork of inconsistent rulings, laws, and regulations.

1. Katanga Johnson, "U.S. House targets 'predatory lenders', votes to repeal Trump banking rule," *Reuters* (June 24, 2021), *available at* <https://www.reuters.com/world/us/us-house-targets-predatory-lenders-votes-repeal-trump-banking-rule-2021-06-24>.

2. 85 Fed. Reg. 211 at 68743.

3. Michael Calhoun, “Bank regulator’s True Lender Rule undercuts bank regulatory protections and shelters predatory lending,” *Brookings Institution* (June 21, 2021), *available at* <https://www.brookings.edu/blog/up-front/2021/06/21/bank-regulators-true-lender-rule-undercuts-bank-regulatory-protections-and-shelters-predatory-lending/>.
4. Evan Weinberger & Claire Hao, “House Votes to Repeal Trump-Era ‘True Lender’ Rule,” *Bloomberg Law* (June 24, 2021), *available at* <https://news.bloomberglaw.com/banking-law/house-votes-to-repeal-trump-administrations-true-lender-rule>.
5. Katanga Johnson, Several U.S. states sue banking regulator over ‘true lender’ rule,” *Reuters* (Jan. 5, 2021), *available at* <https://www.reuters.com/article/us-usa-lending-lawsuit-idUSKBN29A1X1>.
6. “A joint resolution providing for congressional disapproval,” S. J. Res. 15, 117th Cong. (2021).
7. *See e.g.*, Fintech: A Bridge to Economic Inclusion, *Seminar hosted by the FDIC* (June 24, 2020), *agenda available at* <https://www.fdic.gov/news/events/banking-on-data/index.html>; “Access to Credit under the Microscope: Financial Inclusion from Microfinance to Fintech,” *Discussion hosted by the Johns Hopkins School of Advanced International Studies* (Oct. 22, 2020), *available at* <https://sais.jhu.edu/news-press/event-recap/access-credit-under-microscope-financial-inclusion-microfinance-fintech>; Steven Harras, “Fintech pitched as credit lifeline for newly arrived immigrants,” *Roll Call* (Mar. 9, 2021), *available at* rollcall.com/2021/03/09/fintech-pitched-as-credit-lifeline-for-newly-arrived-immigrants/; James Ryan, “This is How Fintech Ensures Equal Access to Finance,” *Entrepreneur* (Oct. 5, 2020), *available at* <https://www.entrepreneur.com/article/357230>.
8. Julapa Jagtiani & Catherine Lemieux, “Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information” (Dec. 16, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096098.
9. Assurance of Discontinuance, *In re Avant of Colorado, LLC and Marlette Funding, LLC*, *Colorado Attorney General* (Aug. 7, 2020), *available at* <https://coag.gov/app/uploads/2020/08/Avant-Marlette-Colorado-Fully-Executed-AOD.pdf>.
10. The Colorado Attorney General cites *Madden* on this point. *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).
11. The Colorado Attorney General cites a series of cases for its “predominant economic interest” argument, including a California District Court case considering “the totality of the circumstances and apply[ing] a ‘predominant economic interest,’ which examines which party or entity has the predominant economic interest in the transaction,” (*CFPB v. CashCall, Inc.*, No. CV157522JFWRAOX, 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016)) and a Ninth Circuit Court of Appeals case where the true lender test focused on the party that “assumes the financial risk of the transaction,” (*Easter v. Am. W. Fin.*, 381 F.3d 948, 955 (9th Cir. 2004)).

12. On this final point, the parties cited state law requiring consideration of loan permissibility at inception and the ability of the assignee to stand in the shoes of the assignor, in addition to including reference to the OCC's Valid When Made rule adopted during the pendency of the enforcement action. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33530 (June 2, 2020). An FDIC rule promulgated at the same time is also cited, which notes that "whether interest on a loan is permissible . . . is determined at the time the loan is made," though the FDIC also says it does not address the true lender question and it "continues to support the position that it will view unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s)." Federal Interest Rate Authority, 85 Fed. Reg. 44146-01 (July 22, 2020).
13. "Colorado Attorney General's Office settles lawsuit against lenders for exceeding state interest rate limits on consumer loans," Press Release, *Colorado Attorney General* (Aug. 18, 2020), *available at* <https://coag.gov/press-releases/8-18-20/>.
14. Loan Shark Prevention Act, H.R. 2930, S. 1389, 116th Cong. (2019).
15. Robert Hockett, "Sanders And Ocasio-Cortez Offer REAL 'Financial Choice' With Their Loanshark Prevention Act," *Forbes* (May 13, 2019), *available at* <https://www.forbes.com/sites/rhockett/2019/05/13/sanders-and-ocasio-cortez-offer-real-financial-choice/>.
16. Karen Webster, "Why The Loan Shark Prevention Act Will Harm Consumers," *PYMNTS.com* (May 13, 2019), *available at* <https://www.pymnts.com/economy/2019/sanders-ocasio-cortez-credit-card-interest-rate-caps-loan-shark-prevention-act/>.

RELATED CAPABILITIES

- Finance
- Fintech
- Financial Regulation Compliance & Investigations

MEET THE TEAM



Stanton R. Koppel

San Francisco

stanton.koppel@bclplaw.com

+1 415 675 3437

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.