OCC Proposes "True Lender" Rule: Four Things To Know

On July 20, 2020, the Office of the Comptroller of the Currency (OCC) released a proposed rule intended to establish a bright-line test to identify the "true lender" in lending partnerships between national banks and federal savings associations, and third parties. In these partnerships, third parties provide marketing, application processing, or other origination-related services, and then purchase loans made by banks shortly after origination. Uncertainty in this area has caused confusion because the identity of the lender determines which state's interest rate limits apply to a loan: if the bank is the lender, then the law of the bank's home state applies, and other state interest rate limitations are preempted. When paired with the OCC's recently issued *Madden*-fix final regulation, the proposal, if finalized, would bring certainty to lending relationships that have been fraught with uncertainty for a number of years. Comments on the proposed rule are due September 3, 2020.

1 The proposed rule offers a bright-line standard: a bank is the lender if it "is named as the lender in the loan agreement" or "funds the loan."

The OCC's proposal provides a straightforward test for determining when, in a lending relationship between a bank and a third party, the bank is the "true lender." Under the proposed rule, a national bank or federal savings association "makes" a loan if, as of the date the loan is originated, (1) the bank "is named as the lender in the loan agreement" or (2) the bank "funds the loan." This bright-line standard would make it easy to identify the lender and, therefore, which state's usury limits apply to the loan. The determination of which entity made the loan under the proposal would be complete as of the date the loan is originated; and under the valid-when-made doctrine (affirmed in the OCC's *Madden*-fix final rule), the validity of the loan as a bank-made loan would not change even if the bank were to subsequently transfer the loan or an interest in the loan.

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2 Loans made under third-party lending partnerships remain subject to extensive federal regulations that discourage predatory lending practices.

Even before the OCC's issuance of the true lender proposed rule, community advocates and others had voiced concern that a "true lender" rule would encourage predatory payday lending practices in the federal banking system. In its proposal, the OCC emphasizes that when a bank partners with a third party to offer a lending program, if a bank is deemed to have made loans issued under that program, then the bank is responsible for compliance with an extensive framework of safety and soundness standards, consumer protection and fair lending laws, and laws prohibiting unfair and deceptive practices. The proposed rule makes clear that, in situations when a bank is deemed to have made a loan, the OCC expects the bank to maintain prudent credit underwriting practices, loan documentation practices that allow the bank to (among other things) assess risk on an ongoing basis, and have appropriate internal controls and information systems to assess and manage the risks associated with its lending activities. The OCC's proposed rule emphasizes that "any lending practices that take unfair advantage of borrowers, or that have a detrimental impact on communities conflict with the high standards expected of banks." By doing so, the OCC addresses concerns that a clear federal standard for determining who makes a loan could invite a resurgence of predatory lending practices in the federal banking system.

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3 The proposal is the OCC's latest effort to eliminate legal uncertainty and stabilize the market for bank loans.

Federal law provides that the interest term of a loan made by a national bank or a federal savings association is determined by the law of the state where the lending institution is located, without regard to the state where the

borrower resides. The OCC recognizes that its proposed rule attempts to eliminate uncertainty and confusion introduced by divergent standards in case law for determining which entity makes a loan and, therefore, which state's interest rate limits apply. Some courts have applied fact-intensive and inconsistent multi-factor tests to determine the "true lender" of a loan, while other courts have looked primarily to the entity named in the loan agreement. As the OCC recognizes, some of these approaches "increase the subjectivity in determining who is the true lender and undermine banks' ability to partner with third parties to lend across jurisdictions on a nationwide basis." This lack of a uniform and predictable standard introduced uncertainty into banks' sale of loans into securitization structures; as the OCC explains, "stakeholders cannot reliably determine which entity makes a loan, and therefore the applicability of key aspects of the legal framework as of the date of origination is unclear." Under the OCC's proposed rule, stakeholders can "reliably and consistently identify key aspects of the legal framework applicable to a loan."

The OCC also recognizes that, when combined with its recent final rule attempting to clear up uncertainty caused by the Second Circuit's *Madden* decision, the proposed rule would "provide greater clarity to banks regarding their lending activities." If the OCC finalizes its proposed true lender rule, then once it has been determined that a bank has made a loan, federal law will "determine the interest permitted on the loan" and will "permit the loan to be subsequently sold, assigned, or otherwise transferred without affecting the interest term."

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4 The proposal leaves the "true lender" question unresolved for state banks.

The OCC's proposal addresses only loans made by national banks and federal savings associations; it would not reach state banks, which operate under a different, but substantively similar, statute. The federal agency charged with administering that statute, the Federal Deposit Insurance Corporation, has not yet issued a similar proposal that would apply to state banks. But during a June 2020 online event, Acting Comptroller Brian Brooks said that he expected the FDIC to also promulgate a "true lender" proposed rule.

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