

# Clients & Friends Memo

## Marketplace Lending Update #9: To Thine Own Self Be True? Not Necessarily

May 21, 2021

On May 11, the Senate voted 52-47 (with three Republicans joining 49 Democrats) to pass a joint resolution under the Congressional Review Act ("CRA")<sup>1</sup> to disapprove of (i.e., rescind) the Office of Comptroller of the Currency's final rule relating to "National Banks and Federal Savings Associations as Lenders"<sup>2</sup> (the so-called "True Lender Rule").<sup>3</sup> The House of Representatives has not yet acted on the joint resolution. Given passage of the CRA resolution in the 50/50-Senate, it seems likely that this will be taken up by the House. Moreover, the White House supports the passage of the resolution.<sup>4</sup>

### The OCC's True Lender Rule

The OCC finalized its True Lender Rule on October 27, 2020,<sup>5</sup> and the Rule was published in the *Federal Register* on October 30. The OCC stated that it issued the True Lender Rule in order to clarify confusion that arises when a national bank partners with a non-bank lender, such as a marketplace lender (often referred to as the "bank-origination model").<sup>6</sup> Determining which entity is making the loan (or is the "true lender") determines which laws apply to the loans.

As we have discussed in previous updates,<sup>7</sup> courts generally have developed two different approaches to determine the "true lender." Certain courts focus on the fact that the bank is the party to the loan agreement and is the entity that actually disbursed the proceeds. Much like the

<sup>1</sup> 5 U.S.C. §§ 801-808.

<sup>2</sup> 85 Fed. Reg. 68742 (October 30, 2020) (available at: <https://www.federalregister.gov/documents/2020/10/30/2020-24134/national-banks-and-federal-savings-associations-as-lenders>).

<sup>3</sup> S.J.Res.15 – 117th Congress (2021-2022) (available at: <https://www.congress.gov/bill/117th-congress/senate-joint-resolution/15?r=1&s=8>).

<sup>4</sup> See Statement of Administration Policy on S.J. Res. 15 (May 11, 2021) (available at: <https://www.whitehouse.gov/wp-content/uploads/2021/05/SAP-S.J.-Res-15.pdf>).

<sup>5</sup> <https://www.occ.gov/news-issuances/federal-register/2020/85fr68742.pdf>.

<sup>6</sup> For a discussion of the bank origination model, see our Clients & Friends Memo, [Marketplace Lending Update: Who's My Lender?](#) (Mar. 14, 2018).

<sup>7</sup> See *id.*

OCC's True Lender Rule, this approach results in the bank being determined as the true lender, and that federal preemption therefore applies. Other courts, however, conduct a broader analysis, focusing on the origination and underwriting of a loan, as well as any material interest in the extension of credit, if any, the bank retains after origination. These courts usually conclude that the nonbank marketing partner company is the true lender and, therefore, federal preemption does not apply.

As noted above, the OCC's True Lender Rule took the tack that generally leads to the national bank being viewed as the true lender. The rule states that a national bank is the true lender if, as of the date of origination, (1) the national bank is named as the lender in the loan agreement for a loan and another bank funds that loan, or (2) the national bank itself funds the loan.<sup>8</sup> The one difference in the final rule from the proposal was a clarification that "if, as of the date of origination, one bank is named as the lender in the loan agreement and another bank funds the loan, the bank that is named as the lender in the loan agreement makes the loan."<sup>9</sup>

Former Acting Comptroller of the Currency Brooks recently testified before the Senate Banking Committee to defend the True Lender Rule. He stated in his testimony that the True Lender Rule was a companion rule to the "Valid-When-Made" rule finalized in June 2020.<sup>10</sup> He noted that both the Valid-When-Made and True Lender rules were in response to the decision in *Madden v. Midland Funding LLC*<sup>11</sup> about which he stated "was at a minimum a legally debatable decision and not in line with either preexisting precedent nor later authorities."<sup>12</sup> While the True Lender Rule does bear some relationship with the Valid-When-Made Rule, the Valid-When-Made Rule's impact is more far-reaching.<sup>13</sup> Moreover, as former Acting Comptroller Brooks correctly noted in his testimony, a CRA joint resolution regarding the True Lender Rule does not undo the Valid-When-Made rules implemented by the OCC and FDIC. "That means that the rule today is that both national banks (under the OCC's rule) and state banks (under the FDIC's rule) may originate loans at an interest rate lawful under the law of the state where the bank is located, and may sell such loans to nonbank investors, without regard to interest rate caps in the state where the borrower or downstream investor is located. Nullification of the True Lender Rule will not change that."<sup>14</sup>

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<sup>8</sup> See 12 C.F.R. 7.1031(b).

<sup>9</sup> 12 C.F.R. 7.1031(c).

<sup>10</sup> The Valid-When-Made rule is available at 85 Fed. Reg. 33530 (June 2, 2020).

<sup>11</sup> 786 F.3d 246 (2d Cir. 2015).

<sup>12</sup> Testimony of Brian P. Brooks before the Senate Comm. on Banking, Housing, and Urban Affairs at 5 (April 28, 2021) (available at: <https://www.banking.senate.gov/imo/media/doc/Brooks%20Testimony%204-28-21.pdf>) ("Brooks Testimony")

<sup>13</sup> The FDIC adopted a similar Valid-When-Made Rule that is applicable to state banks. See 85 Fed. Reg. 44146 (July 22, 2020).

<sup>14</sup> Brooks Testimony at 2.

Notwithstanding the OCC's stated reasoning for the True Lender Rule, the Rule has a number of critics. In arguing for the CRA joint resolution, Senate Majority Leader Chuck Schumer noted the more than 40 states that have passed laws to limit predatory, usurious lending, and that repealing the OCC True Lender Rule would repeal a rule that he stated "permits predatory lenders to exploit small businesses and working Americans."<sup>15</sup>

Additionally, the Attorneys General of eight states have sued to overturn the OCC's True Lender Rule.<sup>16</sup> They criticize the rule as unlawful, contrary to previous OCC opposition to what the OCC once characterized as rent-a-bank arrangements, and contrary to state efforts to protect their citizens from usury.<sup>17</sup> The eight AGs go on to criticize the process the OCC undertook as rushed and not consistent with the Administrative Procedures Act.<sup>18</sup>

### **Congressional Review Act**

Congress has the ability to overrule an agency action at any time through the normal legislative process, but the Congressional Review Act provides expedited procedures for Congressional review of agency rules,<sup>19</sup> allowing for passage in the Senate with a simple majority if considered in the allotted time periods. Generally, that review period is 60 session or legislative days from the later of when Congress receives the report from the agency implementing the rule or the rule is published in the Federal Register (or in the case of a Major Rule, as defined in the CRA, the required report from the GAO).<sup>20</sup> Because the True Lender rule was finalized toward the end of the 116th Congress, the CRA provides an additional "lookback period" as the 117th Congress has begun, and is especially relevant in instances such as those we find today, with a change in party in the White House and both chambers of Congress having majorities of the same party.<sup>21</sup> For rules submitted at the end of a Congressional session that wouldn't give the full 60 session days in order for the Congress to act, the lookback period allows for a new period for review and treats the rule as if it were submitted on the 15th legislative or session day in each respective chamber.<sup>22</sup> The result of a CRA resolution of disapproval passed by both chambers of Congress and signed by the President is that, in the case of a rule such as the True Lender Rule that has already taken effect,

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<sup>15</sup> Remarks of Senator Chuck Schumer on Senate Vote on Congressional Review Act Resolution to Repeal Trump-Era True Lender Rule (May 11, 2021) (available at: <https://www.democrats.senate.gov/news/press-releases/schumer-remarks-on-senate-vote-on-congressional-review-act-resolution-to-repeal-trump-era-true-lender-rule>).

<sup>16</sup> See Complaint against The Office of the Comptroller of the Currency and Brian P. Brooks in his official capacity as Acting Comptroller of the Currency (available at: [https://ag.ny.gov/sites/default/files/01.05.21\\_complaint\\_doc\\_no\\_1.pdf](https://ag.ny.gov/sites/default/files/01.05.21_complaint_doc_no_1.pdf)).

<sup>17</sup> See *id.*

<sup>18</sup> See *id.*

<sup>19</sup> 5 U.S.C. § 804 uses the Administrative Procedures Act definition of a rule found in 5 U.S.C. § 551. This definition is broader than just rules subject to notice-and-comment rulemaking, and can include issuances such as agency guidance.

<sup>20</sup> The OCC's True Lender Rule was deemed not to be a major rule by OMB.

<sup>21</sup> See CRS Report R46690, *Congressional Review Act Issues for the 117th Congress: The Lookback Mechanism and Effects of Disapproval*, by Maeve P. Carey and Christopher M. Davis.

<sup>22</sup> See 5 U.S.C. § 802(e)(2).

the rule will no longer continue in effect and shall be treated as though it had never taken effect.<sup>23</sup> Additionally, the particularly blunt tool of CRA review is that the rule “may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued, unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule.”<sup>24</sup>

### Implications for Marketplace Loans

What are the implications for marketplace loans if the House and President Biden continue the CRA process to repeal the OCC's True Lender Rule? The simple answer is immediately above – the True Lender Rule would be repealed as if it never took effect, and the OCC wouldn't be able to issue a substantially similar rule without an act of Congress. From a practical perspective, it's not clear that this will have a major impact. Granted, the bright line test that the OCC rule articulated was welcomed in some corners as providing clarity, and would possibly have nudged some courts to take the approach of looking solely at the agreement rather than conducting the broader analysis on all aspects of the origination and underwriting of a loan, as well as any material interest in the extension of credit. During the comment period for the then-proposed rule, supporters of the rule noted that the rule could be improved by, among other things, limiting the scope of an overly broad rule, and offering more guidance on any loans that carry an APR above 36%.<sup>25</sup> Though the OCC did not incorporate any of those comments into the final True Lender Rule, the OCC under the Biden Administration could have possibly implemented changes such as those suggested in comments on the proposal, but the blunt tool of a CRA disapproval likely won't allow for any such improvements.

It has been unlikely that the FDIC would act to implement a similar True Lender Rule,<sup>26</sup> and this action by the Senate would seem to ensure that the FDIC would not pursue a similar rulemaking in the near term. While the True Lender Rule is a complement to the Valid-When-Made Rule, the rescission of the True Lender rule would not materially undermine the impact of the Valid-When-Made Rule. As noted above, though *Madden* is still a controlling precedent in the

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<sup>23</sup> 5 U.S.C. § 801(f).

<sup>24</sup> 5 U.S.C. § 801(b)(2).

<sup>25</sup> See Letter from Virginia O'Neill to OCC (Sep. 3, 2020) (“ABA Comment”) (available at: <https://www.regulations.gov/comment/OCC-2020-0026-0196>) and Letter from Nathaniel L. Hoopes to OCC (Sep. 3, 2020) (“Marketplace Lenders Association Comment”) (available at: <https://www.regulations.gov/comment/OCC-2020-0026-0276>).

<sup>26</sup> Leonard Chanin, Deputy to the FDIC Chairman, answering a question at a Practising Law Institute presentation in December 2020, stated “Our authority to determine true lender is not parallel to that of the OCC. That is, we do not have the same, if you will, preemptive authority that the OCC has. The OCC has the authority to determine when a loan is, quote, “made.” We do not have that same authority under the FDI Act. We have the authority to determine valid-when-made under the statute, but we simply don't have the ability to decide or to state that if a bank, for example, originates a loan, is on the paper, the note, that it is a true lender regardless of what state laws or other court decisions in other jurisdictions may state.” (available at: <https://www.pli.edu/programs/consumer-financial-services-institute?t=ondemand&p=278961> (subscription may be required)).

Second Circuit, the Valid-When-Made rule and most precedent supports the notion that banks may originate loans at an interest rate lawful under the law of the state where the bank is located, and may sell such loans to nonbank investors, without regard to interest rate caps in the state where the borrower or downstream investor is located. It thus remains uncertain what will be the impact of the Valid-When-Made Rule, with or without the True Lender Rule.

While the absence of the OCC's True Lender Rule would mean a likely continued split in approach by courts in looking at who the true lender is in order to decide what law applies, we believe a repeal of the OCC's True Lender Rule would be a largely symbolic gesture. The risks for marketplace loans basically remain the same as they have been. The True Lender Rule has only been in place for about six months, and so may not be an underpinning of very many arrangements yet. We believe the best ways to mitigate the risks of states challenging bank-origination model loans include (1) ensuring loan agreements have strong arbitration clauses reflecting contractual agreement to arbitrate any claims and not allow claims to be arbitrated on a class action basis,<sup>27</sup> and (2) limiting the interest rates to below the threshold typically targeted by the CFPB and the state AGs (usually, 36%). As the Marketplace Lenders Association noted in its comment letter, its members commit to lend at no greater than a 36% APR that is consistent with the Military Lending Act. Loans at rates above this level would appear more likely to gain scrutiny first, and leave the likelihood of challenge for loans below that rate low.

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<sup>27</sup> See *American Express Co. et al v. Italian Colors Restaurant et al.*, 570 U.S. 228 (2013) (holding that the Federal Arbitration Act does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery).