Center for Responsible Lending

# The OCC and FDIC Plan to Trample State Laws by Gutting the Longstanding "True Lender" Doctrine

August 10, 2020

**Overview.** For years, predatory lenders have sought ways to avoid state interest rate limits. One scheme has been the "rent-a-bank" scheme. Under this scheme, a non-bank lender finds a bank willing to be the nominal originator of the non-bank lender's high-cost loan, because banks are generally exempted from complying with state interest rate laws. State regulators, state attorneys general, and consumers have had success in the courts stopping these schemes based on a legal doctrine referred to as the "true lender" doctrine, and there are only a handful of rent-a-bank schemes underway today. But the OCC has recently proposed a rule gutting that doctrine, which would stamp the agency's blessing on rent-a-bank schemes with national banks, trample state laws, and invite a flood of rent-a-bank schemes across the country. The FDIC may soon do the same, which would stamp the same blessing on rent-a-bank schemes with state-chartered banks.

**States play the central role in regulating the cost of lending**. At least 45 states and the District of Columbia (DC) impose interest rate caps on some consumer loans. Among those that cap rates, the median annual rate including all fees is 38.5% for a $500, six-month loan; 31% for a $2,000, two-year loan; and 25% for a $10,000, five-year loan.

**Rent-a-bank schemes attempt to launder loans through banks to avoid state rate caps.** With rent-a-bank schemes, a predatory non-bank lender decides that they want to lend at higher rates than what is allowed by state law, frequently loans of 100% APR or more, even in states that have a 36% interest rate cap or less. They find a bank that is willing to pose as the original lender because banks are generally exempted from state interest rate laws. Predatory lenders claim the bank is the "true lender," and that, thus, the loans do not have to comply with state laws. The bank's name is on the loan documents, though the non-bank often provides all the capital for the loans, and after origination, the bank typically sells the loans or receivables back to the non-bank lender. The non-bank lender handles marketing, consumer interactions, and servicing.

**Loans made through rent-a-bank schemes are some of the most predatory on the market.** High-cost online, non-bank lenders, including OppLoans, Elevate's Elastic and Rise, Enova's NetCredit, LoanMart's Choice Cash, EasyPay, Personify Financial, and Verge Credit, launder their outrageously high interest rate loans (e.g., 99.99% APR or 179.99% APR), through banks such as Republic Bank & Trust and FinWise Bank in order to skirt state laws. Most of the banks engaged in rent-a-bank schemes are FDIC-supervised. OCC-supervised Stride Bank out of Oklahoma facilitates Verge loans, and World Business Lenders uses OCC-supervised Axos Bank to make predatory loans to small businesses. *See* National Consumer Law Center, High-Cost Rent-a-Bank Loan Watch List, https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html.

**"True Lender" is a longstanding anti-evasion doctrine, which looks to the substance of the transaction over its form.** Applying the true lender doctrine, courts looks at many factors, but generally hold that the true lender of a loan is the party with the predominant economic interest in the loan. In rent-a-bank schemes, the true lender is always the predatory non-bank lender--which means that the loan should not be able to avoid state interest rate limits. Most recently, the District of Columbia filed suit against Elevate Credit, Inc. alleging that it is the true lender of loans made in D.C. well in excess of the District's rate cap.

**The OCC, under Acting Comptroller Brian Brooks, has proposed a rule based on form over substance that would gut the true lender doctrine.** The OCC's proposal provides that the bank is the "true lender" so long as the bank's name is on the loan agreement or the bank funds the loan. This rule would make it exceedingly easy for rent-a-bank schemes to assert that the national bank is the "true lender." Brooks has said he intends for this rule to shelter rent-a-bank arrangements from litigation alleging violation of state law. The FDIC may soon propose a similar rule for state-chartered banks. Each rule would fuel high-cost predatory lending in all 50 states.

**Non-banks have been aggressively seeking help from federal regulators to avoid state law.** Non-bank lenders, which are subject to interest rate limits in the vast majority of states, have been pushing federal regulators to find ways for them to take advantage of banks' preemptive privileges. In turn, the regulators have pursued a series of aggressive attempts to expand their authority to preempt state laws. First, the OCC has moved forward on a "fintech" charter that would enable non-banks that do not accept deposits to enjoy banks' interest rate preemption privileges. New York sued the OCC alleging the agency lacks authority to issue that charter, and a Federal District Court ruled in the state's favor. In another effort, both the FDIC and the OCC have issued rules that seek to allow non-banks to disregard a Second Circuit court ruling, *Madden*, which held that the preemption privilege the national bank holds does not transfer to a non-bank assignee. The California, Illinois, and New York attorneys general recently challenged the OCC rule in court, and the FDIC rule may also be subject to legal challenge. The FDIC is also seeking to expand charters for industrial banks, which will make it much easier for non-banks to obtain a bank charter and avoid state laws. Thus, a proposal to gut the true lender doctrine is the latest effort by federal regulators to help non-banks avoid state laws and, like the others, lacks a sound legal or policy basis.

**High-cost lending only fuels financial *exclusion*.** CRL and a coalition of civil rights and consumer groups deeply object to the attempts that banking regulators, online lenders, and others make to justify bank/non-bank arrangements, or preemption of state interest limits more broadly, with claims that these are a path to a more inclusive market, particularly for communities of color. We heard the same claims about predatory subprime mortgage lending until the foreclosure crisis ravaged neighborhoods of color and only widened the racial wealth gap. The suggestion that high-cost lending offers a path toward upward mobility insults those of us who understand that our communities deserve better. High-interest loans will never "make poor people rich."[1] Nor do they help with the lack of income and assets caused by centuries of discrimination and growing inequality. Rather, predatory lending only leaves poor people worse off. Adding the new label "fintech" to high-cost lending makes it easier for banking regulators to justify their support, but it doesn't soften the blow high-cost loans land on struggling families.

**Now is among the worst times imaginable to disrupt safeguards that protect consumers.** We are in the midst of an unprecedented health crisis and a severe economic crisis, with both crises impacting communities of color more heavily than white communities. The future, on both the health and economic fronts, is profoundly uncertain. We are, at the same time, at a pivotal moment in our nation's reckoning with its history of structural racism. Systemic racial barriers persist in virtually every sphere, and the banking and credit arenas are no exception. In fact, racist financial practices are among the most well-known and documented in the history of racial exclusion. As we reevaluate structural racism across our society, we should be critically scrutinizing the effects of financial practices, particularly as they impact Black households' efforts to achieve financial stability and advancement. Instead, gutting the longstanding "true lender" doctrine would open the floodgates to predatory lending. Instead, the agencies should take enforcement actions to stop the handful of banks engaging in rent-a-bank schemes from doing so.

***The OCC and FDIC should table plans to gut the "true lender" doctrine, which is a longstanding anti-evasion provision critical to enforcing state interest rate limits against high-cost predatory lenders.***

****Comments to OCC due Sept. 3: *Email* regs.comments@occ.treas.gov, *Subject: Docket ID OCC–2020–0026*****

[1] *See*, *e.g.*, Remarks of Acting Comptroller of the Currency Brian Brooks to the Online Lending Policy Institute, June 11, 2020, https://www.youtube.com/watch?v=Ae_SoZeRbxM, at 33:00 (stating "I want to make poor people rich" while addressing financial inclusion, in a conversation where he also states that his personal belief is that "price controls generally create shortages" and that "if we believe in market pricing for hamburgers, for jeans, for automobiles, I'm not sure why we don't believe in market rates for money; it's another commodity, and we want it to flow freely").

Contacts: Ashley Harrington: ashley.harrington@responsiblelending.org
Rebecca Borné: rebecca.borne@responsiblelending.org