Statement for the Record: "Rent-a-Bank Schemes and New Debt Traps"

Statements & Comments

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STATEMENT FOR THE RECORD
FROM THE CONFERENCE OF STATE BANK SUPERVISORS
TO THE U.S. HOUSE FINANCIAL SERVICES COMMITTEE HEARING ON
“RENT-A-BANK SCHEMES AND NEW DEBT TRAPS: ASSESSING EFFORTS TO EVADE STATE CONSUMER PROTECTIONS AND INTEREST RATE CAPS”

FEBRUARY 5, 2020

The Conference of State Bank Supervisors (CSBS) is the nationwide organization of banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. The mission of CSBS is to support the leadership role of state banking supervisors in advancing the state banking system; ensuring safety and soundness; promoting economic growth and consumer protection; and fostering innovative state regulation of the financial services industry. State regulators charter and supervise 79 percent of all banks in the United States. In addition, state regulators license and supervise a variety of non- bank financial services providers, including fintech, mortgage lending, money transmission, and consumer finance. CSBS, on behalf of state regulators, also operates the Nationwide Multistate Licensing System (NMLS) to license and register those engaged in mortgage, money transmission, and other non-bank financial services industries.

CSBS appreciates the opportunity to submit this statement for the record. Today’s hearing points to an issue that CSBS flagged in our comments to the Office of the Comptroller of the Currency’s (OCC) and the Federal Deposit Insurance Corporation’s (FDIC) (collectively “the agencies”) recent proposals that would essentially overturn the decision of the United States Court of Appeals for the Second Circuit in the Madden v. Midland Funding, LLC. While the agencies are seeking to provide greater certainty as to the ability of assignees to enforce interest rate provisions of loans originated by banks, CSBS believes, as bank partnerships with non- banks continue to increase, the “true lender” doctrine needs to be preserved as an important tool for addressing rent-a-bank arrangements and preserving state consumer protections.

OCC and FDIC Proposals Addressing Purported Uncertainty Arising From Madden Ruling

The OCC’s proposed rule, titled “Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred” is intended to clarify that when a national bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer. Similarly, the FDIC’s proposed rule, titled “Federal Interest Rate Authority” would, in addition to codifying several long-standing interpretations regarding state banks’ federal interest rate authority, provide that whether interest on a loan is permissible under section 27 would be determined at the time the loan is made, and would not be affected by subsequent events, including the sale, assignment, or other transfer of the loan.

CSBS appreciates the intention to provide greater clarity and certainty to assignees of loans made by national and state banks. We agree that the ability of banks to assign loans is an important tool to manage liquidity and ensure safety and soundness. Additionally, there are many legitimate and beneficial financial arrangements that involve loan assignment, such as securitization and debt collection. To the extent that the Madden ruling has created uncertainty as to the ability of banks to engage in these legitimate arrangements, CSBS believes that uncertainty should be reduced.

The OCC and the FDIC should not address this uncertainty in a manner which either violates federal law or interferes with consumer protection to a greater extent than necessary. As we state in our comment letter to the OCC, the OCC proposed rule has failed to comply with the substantive and procedural requirements applicable to preemption determinations under the National Bank Act.[1] Since the proposed OCC rule is a preemption determination and is not exempt from these requirements, there are serious questions as to its validity which ultimately only undermines the OCC’s objective to provide greater certainty.

To the extent that the proposed rules fail to comply with federal law or preempt state consumer protection laws, such as the true lender doctrine or state regulation of nonbank financial services providers, CSBS would be opposed to the proposed rules.

True Lender Doctrine as a Remedial Tool Afforded by State Law

State regulators stress the importance of preserving and not preempting the rights and remedies afforded under state consumer protection laws, including the true lender doctrine. The agencies' proposals state that they are not intended to impact other recent litigation which deals with the related, but distinct legal question regarding the so-called "true lender" doctrine. Specifically, the OCC proposal states that "[t]his rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party. The true lender issue, which has been considered by courts recently, is outside the scope of this rulemaking." The FDIC proposal states that "[t]he regulations do not address the question of whether a State bank or insured branch of a foreign bank is a real party in interest with respect to a loan or has an economic interest in the loan under state law, e.g., which entity is the 'true lender.'"

CSBS appreciates the agencies' intent to preserve the true lender doctrine as an important remedial tool provided by state law. The doctrine is utilized in cases in which a nonbank enters into a lending arrangement with a bank to obtain the benefits of interest rate exportation and evade otherwise applicable state consumer protection laws. In these arrangements, the nonbank typically markets the loan, makes all the credit decisions and directs its bank-partner to originate its loans only to purchase them from the bank within days. To challenge these arrangements, consumers and state officials have brought against the nonbank partner asserting that, although the bank is the nominal lender, the nonbank is the true lender and cannot evade applicable state usury and consumer protection laws.

In reviewing these claims, courts have applied the true lender doctrine by reviewing the substance of the arrangement in light of the totality of the circumstances to determine whether the nonbank has the predominant economic interest in the loan. The essential feature of the doctrine is its heavy reliance on a fact-intensive, totality-of-the-circumstances analysis conducted by courts. The role of courts in reviewing the substance, rather than the form, of these nonbank lending arrangements is essential because courts are uniquely capable of identifying, ex post, the real incentives of the parties without regard to the obfuscating names or forms and molding the shape of the doctrine to forestall attempted circumvention.

CSBS believes the proposed rules should preserve, not preempt, rights and remedies afforded under state consumer protection laws, including the true lender doctrine. For this reason, we appreciate the FDIC taking 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).” Unlike the FDIC’s proposal, the OCC’s proposal does not state whether or not it will view unfavorably entities that partner with a national bank with the sole goal of evading a lower interest rate established under otherwise applicable state law. Regardless of the OCC’s views, both the OCC’s and FDIC’s supervisory role in reviewing third party lending arrangements to prevent unsafe and unsound practices on an ex ante basis should not displace the role of courts and state officials in relying on the true lender doctrine to remediate harm on an ex post basis. Rather, these regulatory and judicial authorities should be exercised concurrently and independently—just as they were before and after the Madden decision.

Relatedly, CSBS believes the true lender doctrine should be preserved as a state law remedy in light of federalism principles. Issues of credit affordability and access are inherently local concerns which are best balanced at the state and local level given the wide variation in the financial circumstances across the country. It is important for consumers to maintain control over the rates, terms and conditions at which credit is offered in their state. Allowing a nonbank to evade otherwise applicable interest rate caps interferes with the ability of consumers, as citizens, to strike the desired balance between credit access and affordability. The true lender doctrine is an important tool that consumers can rely on to prevent such interference. CSBS would not support the proposed rules to the extent they result in the preemption of true lender claims and prevent consumers, as citizens, from maintaining control over their economic lives through the medium of state regulation.

To ensure that the proposed rules are not used to circumvent the state law true lender doctrine, CSBS has recommended that the FDIC and OCC revise their proposed rule text to ensure that the continued enforceability of the interest term by nonbank assignees does not apply in those arrangements in which the nonbank, rather than the bank, has the predominant economic interest in the loan and thus is the true lender. Through this recommended true lender proviso, CSBS seeks to ensure that the rule limits the application of the valid-when-made principle to circumstances in which the bank is, in fact, the true lender so that (1) state law true lender claims remain viable, (2) the relevant state law remains the law of the state in which consumer resides and (3) the traditional role of courts in making this determination is preserved.

It is worth noting that adopting the recommended proviso would not interfere with the objective of restoring certainty and returning to the pre-Madden status quo. As the OCC has previously noted, the valid when made principle is a common law doctrine and thus, if it existed pre- Madden, it had to be incorporated into state law. We hope the OCC and

FDIC will revise the proposed rule texts in order to solidify intentions to preserve the rights and remedies afforded under the true lender doctrine.

Conclusion

To reiterate, given the importance of loan assignment for safety and soundness and certain legitimate financial arrangements, we appreciate the intention to provide greater clarity and certainty to assignees of national and state bank loans regarding the permissibility of the interest rates.

Additionally, while we appreciate the stated intention not to interfere with the true lender doctrine, we believe this intention should be reflected in the proposed regulations and also that clarity should be provided regarding the impact on other state consumer protection laws. State bank regulators believe true lender needs to be preserved as an important tool for address rent-a- bank schemes and preserving state consumer protections. CSBS and state regulators are willing to consult further with the OCC as well as the FDIC as the agencies consider how to proceed with the proposed rulemakings.

We also look forward to working with the Committee on these issues and other issues vital to the financial services industry.

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1 See 12 U.S.C. 25b.

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