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Lawsuits Create Uncertainty for Rent-a-Bank Rules

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In the past few months, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) have proposed and enacted new rules to address ambiguity surrounding “rent-a-bank” or “rent-a-charter” arrangements. Under rent-a-bank or rent-a-charter arrangements, chartered banks assign loans to non-bank lenders. In a typical rent-a-bank arrangement, a federally chartered bank underwrites and originates a loan, and the bank then assigns that loan to a non-bank lender who markets, funds, and collects on the loan. Importantly, federally chartered banks are exempt from state usury laws because the banks are governed exclusively by federal law. In contrast, non-bank lenders do not enjoy federal preemption and are therefore subject to state usury laws which generally cap the interest rates that the non-bank lenders can charge on loans. Federal courts have struggled with whether rent-a-bank arrangements allow the non-bank to “borrow” the chartered bank’s federal preemption from state usury laws.

In response to various tests applied by federal courts in rent-a-bank cases, the OCC and FDIC have recently enacted the “valid-when-made” rule. The OCC has also proposed a “true lender” rule.

The OCC and FDIC valid-when-made rule clarifies that if the interest rate in a loan agreement that was originated by a bank was non-usurious at the time of origination, the loan cannot become usurious when it is assigned to a non-bank. In other words, the non-bank may lawfully charge interest at the original rate set by the bank, even if that rate would violate state usury laws. In this way, the non-bank may circumvent state usury laws and “borrow” the bank’s preemption.

The OCC and the FDIC valid-when-made rule does not address who the “true lender” is after a loan is assigned. Is it the bank who originated the loan or the non-bank who is collecting on it? In absence of a rule, many courts have applied a fact-dependent test to determine who the true lender is, considering factors like which entity has the predominant economic interest, which entity placed its money at risk, and the circumstances surrounding the loan application and assignment. Often, this analysis results in the court deeming the non-bank as the true lender; when the non-bank is the true lender, it does not borrow the bank’s preemption and remains subject to state usury laws. However, in July 2020, the OCC proposed a rule that abandons the federal courts’ fact-dependent test in favor of a mechanical approach.

The OCC's proposed true lender rule clarifies that a bank is the true lender when, as of the date of origination, it 1) is named as the lender in the loan agreement or 2) funds the loan. Under the OCC's proposed rule, if a bank that originates a loan subsequently transfers the loan, this does not change the fact that the bank is the lender. Thus, if either of the test's two factors are satisfied, the bank's federal preemption would extend to the non-bank and the non-bank would not be subject to state usury laws. The FDIC has not yet proposed a true lender rule, but FDIC Chair McWilliams has indicated that the agency is developing one.

The comment period for the OCC's proposed "true lender" rule closed on September 3, 2020. Supporters of the rule, including fintech companies and some banks, praised the proposed rule for providing an easily-applied test. Some supporters also claimed that the rule will promote the availability of credit, which may be increasingly important to consumers due to economic difficulties caused by the COVID-19 pandemic. However, consumer rights organizations, state government agencies, and attorneys general have opposed the rule, alleging that it will facilitate predatory lending by creating a loophole for unregulated lenders to avoid state usury laws and charge exploitative interest rates. The OCC has not yet issued a final rule.

Both the valid-when-made and true lender rules have spurred lawsuits. On July 29, 2020, the attorneys general of Illinois, California, and New York filed a federal lawsuit challenging the OCC's true lender rule. In their complaint, the attorneys general allege that the rule should be invalidated because 1) the OCC failed to comply with the procedures of the Administrative Procedures Act, 2) the OCC lacked authority to issue the rule under the National Bank Act, and 3) the rule is arbitrary and capricious because the OCC failed to consider how the rule would facilitate predatory lending by allowing non-bank lenders to bypass state interest-rate caps. In August, several states, including Minnesota, filed suit against the FDIC challenging its valid-when-made rule on similar grounds; other states have challenged the OCC's version of this rule.

Until these lawsuits are resolved, uncertainty surrounding the valid-when-made and true lender doctrines persists.