

Locke Lord QuickStudy: OCC Issues Final Rule Addressing the “True Lender” Problem

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On October 30, 2020, the Office of the Comptroller of the Currency (the “OCC”) published its final rule (the “Rule”) that establishes when a national bank or federal savings association makes a loan and is the “true lender,” including when a bank is involved with a third party lender.¹ The Rule will be effective December 29, 2020.

Background

On June 2, 2020, the OCC published its final rule clarifying that an assignee of a national bank has the right to collect interest at the same rate as the national bank on loans made by the national bank.² In doing so, the OCC codified the common law doctrine of “valid when made,” which states that a loan that was valid when made will not be rendered usurious by a subsequent transfer. The OCC adopted the “valid when made” doctrine to resolve the legal uncertainty created by Madden v. Midland Funding, LLC, a decision in which the U.S. Court of Appeals for the Second Circuit held that a debt collector assignee of a national bank could not charge the higher interest rate charged by the bank.³ On July 22, 2020, the Federal Deposit Insurance Corporation (“FDIC”) published its final rule extending the benefits of the “valid when made” doctrine to state-chartered banks.⁴ Our analysis of the OCC rule is available [here](#) and our analysis of the FDIC rule is available [here](#). Neither rule, however, addressed the question of whether a bank is the “true lender” in a transaction where the loan is assigned to the assignee soon after it is made pursuant to an agreement between the bank and the assignee. The Rule finally answers that question, though its scope is limited to national banks and federal savings associations.

The Rule

Under the Rule, a bank makes a loan if, as of the date of origination, it (1) is named as a lender in the loan agreement or (2) funds the loan.⁵ Where one bank is named as the lender in the loan agreement and a different bank funds the loan, the Rule provides that the bank that is named as the lender in the loan agreement is the true lender of that loan.⁶ In response to comments made on the proposed rule, the release also makes clear that when a bank lends money under a warehouse line of credit, the bank is not “funding” the loans made by the warehouse line borrower. Similarly, a bank that purchases retail installment contracts from an auto dealer is not thereby “funding” the loans it purchases.

Critics of the proposed rule argued that it would facilitate “rent-a-charter” schemes in which banks receive fees to “rent” their charter and unique legal status to third parties, thereby enabling the third parties to evade state and local consumer protection laws. The banks can then disclaim responsibility for the loans, leaving consumers

in debt to predatory lenders. In its release accompanying the Rule, the OCC squarely rejects this argument, reasoning that the Rule actually thwarts these schemes by implementing a clear and simple test for determining when a bank makes a loan. Additionally, the OCC notes that such schemes have no place in the federal financial system, and reaffirms its commitment to hold banks accountable for the underwriting standards of the loans they make.

Lingering Uncertainty for State-Chartered Banks

As noted above, the Rule only applies to national banks and federal savings associations. Accordingly, state-chartered banks may reasonably expect “true lender” attacks on specific types of loan transactions to continue. Courts that have addressed the “true lender” issue have employed balancing tests that consider a variety of factors. Furthermore, courts do not always consider the same factors or even give the same factors the same weight, increasing the likelihood of divergent outcomes. Although the FDIC may follow the lead of the OCC in order to promote uniformity, it has yet to propose a similar rule for state-chartered banks. We will continue to monitor the FDIC’s rulemaking process for further developments on this front.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the authors.

¹ National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68,742 (Oct. 30, 2020).

² Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530 (Jun. 2, 2020).

³ Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015).

⁴ Federal Interest Rate Authority, 85 Fed. Reg. 44,146 (Jul. 22, 2020).

⁵ 12 C.F.R. § 7.1031(b).

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