

STATEMENT OF

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Introduction

Chairman Brown, Ranking Member Toomey, and members of the Committee, thank you for the opportunity to appear before you today to discuss the Office of the Comptroller of the Currency's (OCC's) True Lender Rule and its importance for access to credit, bank balance sheet management, and the safety and soundness of the banking system.

It is important to note at the outset that the True Lender Rule¹ was adopted by the OCC following the earlier implementation of the separate "valid when made" rule.² "Valid when made," discussed more fully below, was adopted along substantially similar lines by both the OCC and the Federal Deposit Insurance Corporation (FDIC).³ While a Congressional Review Act resolution has been filed in the House of Representatives and the Senate with respect to the True Lender Rule, the time period for filing any such resolution with respect to the earlier "valid when made" rule elapsed some time ago. 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. As explained below, the purpose of the later-adopted True Lender Rule is simply to clarify when a bank is the true lender with respect to a particular loan and provide a bright line as to when OCC examination and enforcement authority applies to ensure compliance with consumer protection and other legal requirements with respect to the loan. Since the "valid when made" rule will continue in force in any event, it is important to consider the potential negative effects of

¹ 85 FR 68742 (Oct. 30, 2020).

² 85 FR 33530 (June 2, 2020).

³ See 85 FR 44146 (July 22, 2020).

undoing a rule whose purpose is to ensure that banks exercising their authority under “valid when made” principles comply with legal requirements when they engage in secondary market transactions.

“Valid When Made,” Secondary Markets, and Access to Credit: Increasing Credit Availability to Low- and Moderate-Income Americans By Allowing Banks to Leverage Their Balance Sheets Through Fintech and Other Partnerships

The total demand for consumer credit in the United States far exceeds the amount of bank balance sheets dedicated to that business segment.⁴ Moreover, state interest rate caps historically made it harder for residents of some states to access credit than residents of other states. Congress and the Supreme Court have addressed these problems in two ways. First, the Supreme Court’s 1978 decision in *Marquette Nat’l Bank of Minneapolis v. First of Omaha Serv. Corp.*⁵ and Congress’s 1980 enactment of the Depository Institutions Deregulation and Monetary Control Act allowed both national and state banks to export their home state’s interest rate to customers in other states. *Marquette* reached a bipartisan result. The case was successfully argued by Robert Bork, and Justice William Brennan authored the decision for a unanimous Court. Congress’s decision to expand the *Marquette* rule on interest rate exportation to state banks as well as national banks was similarly bipartisan, passing with an overwhelming majority of both Democrats and Republicans and signed into law by President Jimmy Carter. In short, in the inflation crisis of the late 1970s, when the prime rate peaked at 21.50 percent and some states had 8 percent usury caps, American leaders of all political stripes understood the importance of allowing state interest rate exportation to improve access to credit.

⁴ <https://www.federalreserve.gov/releases/g19/current/>.

⁵ 439 U.S. 299 (1978).

The second way Congress addressed the inadequacy of bank balance sheets to address all consumer loan demand is in empowering national banks to sell their loans to third parties. The National Bank Act provides that banks may enter into contracts, and the Supreme Court has held consistently for almost 200 years that banks’ contracting powers specifically include the power to sell and assign their interest in loans to investors.⁶ The implication for credit access is clear: When a bank sells a loan, it frees up balance sheet to make the next loan. This is true when a bank sells a consumer loan to a marketplace lender; when a bank sells a mortgage to one of the GSEs; or when a bank securitizes its credit card receivables. The principle is the same: Banks tap secondary market investors to sell loans and use the proceeds to make more loans. If we think access to credit is a good thing – and Federal Reserve research shows that countries with more widely available credit have lower poverty rates⁷ – it follows that letting banks make more loans rather than less is desirable.

This idea was called into question in the 2015 Second Circuit Court of Appeals decision in *Madden v. Midland Funding LLC*.⁸ In marked contrast to the bipartisan consensus of the late 1970s surrounding interest rate exportation, some advocates cheered *Madden* for enforcing a state usury law and protecting consumers from high interest rates. But the reality of that “protection” was far murkier. Multiple studies of the effect of *Madden* on credit markets found that, when unable to sell higher interest rate loans to investors, banks focused their lending activities on smaller loans to wealthier and higher-credit-score consumers.⁹ One study found that banks in the states subject to the *Madden* ruling reduced lending to LMI borrowers by an

⁶ See *Planters’ Bank of Miss. v. Sharp*, 47 U.S. 301 (1848).

⁷ See, e.g., <https://www.dallasfed.org/-/media/documents/research/ecllett/2006/el0610.pdf>

⁸ 786 F.3d 246 (2d Cir. 2015).

⁹ See Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & Econ. 673, 675 (2017) (cited in *McShannock v. JP Morgan Chase Bank, N.A.*, No. 19-15899 (9th Cir. 2019)).

astounding 64 percent.¹⁰ In short, the available evidence showed that enforcing a state usury limit against a bank-originated loan did not make credit less expensive for LMI borrowers; it made credit less available. This evidence is supported by the analysis of numerous economics and finance professors who submitted a brief *amicus curiae* in support of the OCC’s position in litigation brought by the State of California and others seeking to challenge the “valid when made” rule.¹¹

Madden was at a minimum a legally debatable decision and not in line with either preexisting precedent nor later authorities. In 2005, another federal court of appeals held that “the assignee of a debt ... is free to charge the same interest rate that the assignor ... charged the debtor ... even if the assignee does not have a license that expressly permits the charging of a higher rate.”¹² During the Obama Administration, the Solicitor General opined that the *Madden* court “erred in holding that state usury laws may validly prohibit a national bank’s assignee from enforcing the interest-rate term of a debt assignment that was valid under the law of the State in which the national bank is located.”¹³ And just last year the U.S. Court of Appeals for the Ninth Circuit criticized *Madden* at length in holding that another state law that impaired the ability of national banks to sell loans in the secondary market was preempted.¹⁴

¹⁰ See Piotr Daniesewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* 22 (2018), <https://tinyurl.com/y5s3s7oh>.

¹¹ See <https://www.occ.gov/publications-and-resources/publications/economics/hamiltons-corner/amicus-brief.pdf>.

¹² *Olvera v. Blitt & Gains, P.C.*, 431 F.3d 285, 286, 289 (7th Cir. 2005).

¹³ <https://www.justice.gov/sites/default/files/osg/briefs/2016/06/01/midland.invite.18.pdf>

¹⁴ *McShannock v. JP Morgan Chase Bank NA*, <https://cdn.ca9.uscourts.gov/datastore/opinions/2020/09/22/19-15899.pdf>.

The True Lender Rule: Providing Clarity Necessary to Allocate Responsibility for Legal Compliance

While the OCC and FDIC “valid when made” rules clarified established law regarding banks’ powers to sell loans in the secondary market without jeopardizing the enforceability of the relevant interest-rate terms, it did not specify when the bank was the legal originator of the loan and when a fintech, marketing partner, or other nonbank company was the legal originator. The purpose of the True Lender Rule is to provide clarity on that question.

Prior to the True Lender Rule, courts employed a variety of subjective multifactor balancing tests to determine who the true lender was with respect to a given loan transaction. In New York and Connecticut, the states subject to the *Madden* decision, the question was irrelevant because even if a bank actually originated the loan the interest rate became unenforceable following sale to a nonbank investor. But outside those states, the complicated question of who is the true lender consumed enormous litigation resources to resolve in any given case. In some cases, courts held that a bank was the true lender and thus upheld the enforceability of the transaction against a usury challenge.¹⁵ In other cases presenting similar circumstances, courts held that the bank’s involvement was not sufficient to make it the true lender and held the transaction to violate state usury laws.¹⁶

One purpose of the True Lender Rule was to eliminate the uncertainty caused by subjective multifactor balancing tests – uncertainty that had the potential to seriously disrupt secondary markets (including securitization markets) for consumer loans and reduce access to credit, particularly among those who need it most. It did not seem controversial to simply answer the question of whether the bank or another party was in fact the true originator of a loan.

¹⁵ See, e.g., *Beechum v. Navient Solutions, Inc.*, 2016 WL 5340454 (C.D. Cal. Sept. 20, 2016).

¹⁶ See, e.g., *CFPB v. CashCall, Inc.*, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016).

But another purpose of the True Lender Rule was to address allegations about “rent-a-charter” schemes. While “rent-a-charter” is not a legal or technical concept, OCC staff took the concept to refer to situations in which a nonbank paid a fee to a bank for the sole purpose of evading legal requirements, without the bank actually being involved in loan underwriting, risk management, or legal compliance. In short, the OCC took “rent-a-charter” to mean an arrangement in which the nonbank was seeking to ensure that no one was actually responsible for consumer protection or other compliance obligations.

That is precisely why the OCC, in issuing the True Lender Rule, expressly stated that it would “hold[] banks accountable for all loans they make, including those made in the context of marketplace lending partnerships or other loan sale arrangements.”¹⁷ Specifically, the OCC emphasized its “expectation that all banks [will] establish and maintain prudent credit underwriting practices and comply with applicable law, *even when they partner with third parties*.”¹⁸ If not, “the OCC will not hesitate to use its enforcement authority consistent with its longstanding policy and practice.”¹⁹ This is in contrast with historical practice in which banks sought to minimize their role in loan origination at the same time their marketing partners sought to disclaim responsibility as the true lender. Under the True Lender Rule, the days of each party pointing the finger at the other are over; borrowers and regulators now know who is responsible if the bank either is named on the note or funds the loan on the date of origination. This clarity thus is positive not only for secondary market functioning, but for consumer protection accountability.

¹⁷ <https://www.federalregister.gov/documents/2020/10/30/2020-24134/national-banks-and-federal-savings-associations-as-lenders>.

¹⁸ *Id.*

¹⁹ *Id.*

The OCC has a long history of holding banks accountable for failing to manage the consumer protection obligations and compliance risks of third-party service providers, including those partners involved in making loans to consumers. In the early 2000s, the OCC took several groundbreaking actions that are precedents for preventing abuses in certain relationships.²⁰ Those actions continue to provide an important playbook for consumer protection today and demonstrate the value of strong federal supervision.

True Lender and the Role of States: The Dual Banking System, Parity, and Usury

Some critics of interest rate exportation claim that it undermines state authority over their own credit markets. That has not been the view of leaders of either party historically. As noted above, the *Marquette* decision holding that national banks may export their home states' interest rate to borrowers in other states was argued by Robert Bork and decided by Justice William Brennan writing for a unanimous Supreme Court; the Depository Institutions Deregulation and Monetary Control Act, which extended interest rate exportation powers to state banks, was approved by overwhelming majorities of both parties in Congress and signed into law by President Jimmy Carter; and President Obama's Solicitor General took the position that *Madden*, the most prominent case to criticize interest rate exportation in the context of secondary market loan sales, was wrongly decided. Nonetheless, the argument persists that states should be able to establish the rules for their own credit markets, and that interest rate exportation somehow interferes with that principle.

²⁰ See, e.g., OCC NR 2002-85 (<https://www.occ.gov/news-issuances/news-releases/2002-nr-occ-2002-85.html>); NR 2003-6 (<https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-6.html>); NR 2003-3 (<https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-3.html>).

The most straightforward answer to this concern is that Congress viewed the correct balance of state and federal power through the lens of the dual banking system. In Congress's view, the most important concern was not preserving state usury laws but ensuring that state banks operate on a level playing field as national banks. Thus, as noted, Congress gave state banks the same authority to export their home states' interest rates that national banks enjoyed under *Marquette*.

Second, nothing about the True Lender Rule (as distinct from the "valid when made" rule, which is not under Congressional Review Act challenge) affects state authority to set rules regarding when a state-chartered bank (as opposed to a marketplace lender) is the true originator of a given loan. This is why the OCC and FDIC both adopted versions of the "valid when made" rule, but only the OCC adopted the True Lender Rule. The OCC, as the chartering agency for national banks, has the statutory authority to interpret national bank powers. The FDIC, which is not a chartering agency, lacks that authority with respect to state banks. Thus states remain free to set their own true-lender rules for their own chartered banks if they wish to do so.

Third, nothing about the True Lender Rule alters state authority to license, supervise, and enforce laws applicable to nonbank lenders. In fact, nonbank consumer lenders, including virtually all payday lenders today, operate as state-licensed companies and are subject to state supervision. The OCC supports strong state supervision of the nonbank lenders and encourages states to use the full extent of their authority to protect consumer from abuses that occur among these service providers. The point of the companion "valid when made" and True Lender Rules, however, is that it is not an "abuse" for a bank to exercise its statutory authority to export its lawful interest rate to borrowers in other states and to sell loans including such rates in the secondary market.

Finally, it bears emphasis that it was Congress’s decision – not the OCC’s – to allow both state and national banks to export interest rates. That long-settled decision was not a departure from Alexander Hamilton’s view of state-federal relations in our system of federalism. In the same way that the first Bank of the United States was deemed immune from state taxation because the “power to tax involves the power to destroy” an instrumentality of national economic policy,²¹ a state power to constrain interest rates agreed in loans originated by federally chartered banks would impede the functioning of the national banking system – itself one of the most important aspects of national economic policy. But states can set their own “true lender” rules for their banks in the same way that they can charter their own banks, and the existence of the national banking system is not a threat to state sovereignty in either situation.

Thank you for the opportunity to testify today and I look forward to answering the Committee members’ questions.

²¹ *McCulloch v. Maryland*, 17 U.S. 316 (1819).