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PUBLIC INTEREST COMMENT

COMMENT FOR THE COMPTROLLER OF THE CURRENCY'S PROPOSED RULE REGARDING NATIONAL BANKS AND FEDERAL SAVINGS ASSOCIATIONS AS LENDERS

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National Banks and Federal Savings Associations as Lenders
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We appreciate the opportunity to submit a comment to the Office of the Comptroller of the Currency (OCC) in response to its proposed rulemaking clarifying when a national bank or federal savings association makes a loan and is considered the "true lender" in the context of a partnership between a bank and a third party.[1] The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This comment, therefore, does not represent the views of any particular affected party or special interest group. Rather, it is designed to help the OCC as it considers how to implement these policies. Specifically, the comment seeks to help the OCC provide clarity to banks and credit markets regarding who the true lender is when national banks and other federal savings associations partner with nonbank third parties for the purpose of making a loan.

The ability of a national bank or federal savings association to partner with nonbank third parties without fear that the loans the bank makes will be subject to inconsistent, post hoc laws never intended to govern bank loans is of great importance. By working together to create better products and services, these relationships facilitate access to credit, promote competition, manage

[1] National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44223 (proposed July 22, 2020).

risk, and spur innovation to the benefit of not just banks and their nonbank partners, but consumers and the public more broadly. Unfortunately, some courts have created a great deal of uncertainty surrounding these relationships, by calling into question the validity of contracts formed through this model by redefining what it means to be the true lender in a transaction.[2]

Rather than relying on the underlying contract as the definitive source for determining who the lender is in a given transaction, these courts have substituted their own judgment for that of the contracting parties. They look past the explicit terms of the contract agreed to by the parties at issue and, instead, attempt to determine who should be considered the true lender by assessing who, in the court's view, has the "predominant economic interest" in the loan.[3] For the courts that have adopted this approach, this has proven to be a vague standard with ill-defined parameters that has been applied in varying ways.[4] This is arguably unfair to the parties who consented to the terms of the contract. It also creates legal uncertainty that can significantly affect lending markets and credit availability.

Other courts have rejected this doctrine in favor of the more objective and predictable method of vindicating the contract between the parties as written.[5] In declining to look beyond the contract to subjective intent, some courts have noted that such an exercise is too uncertain and inconsistent and that adopting such a policy would interfere with banks' ability to sell assets,[6] and thus would be contrary to public policy.[7]

The OCC has the opportunity and authority to clarify that, under existing law, national banks and federal savings associations are considered the true lender when they are either the party named as the lender in the contract or the party providing the funds on the day the contract is originated. The OCC has proposed making just such a clarification on the relevant regulations; it should do so.[8] This clarification is fair, is economically sound, and protects consumers.

THE PROPOSAL IS FAIR

Clarifying that a national bank or federal savings association will be considered the true lender when it is the party named as the lender in the contract or when it provides the funds on the day of origination is fair. It is unfair to the parties to invalidate a contract that was freely entered into by the borrower and bank, apply a set of laws neither party to the contract sought to have govern their agreement, and impair the value of an asset that was obtained at an agreed-upon price because of a change in ownership of the asset (in this case the loan and the rights therein) that does not materially change the obligations of the borrower.

The characteristics and terms of a loan, such as the interest rate, are set by the lending bank at the time the contract is originated, consistent with the rights and obligations imposed on

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[2] CFPB v. CashCall, Inc., 2016 WL 4820635, at 5–6 (C.D. Cal. Aug. 31, 2016); CashCall, Inc. v. Morrisey, 2014 WL 2404300, at 1, 7 (W. Va. May 30, 2014); Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359, 1369 (D. Utah 2014).

[3] *CFPB v. CashCall, Inc.*, 2016 WL 4820635, at 7–8 (C.D. Cal. Aug. 31, 2016).

[4] Brian Knight, *Federalism and Federalization on the Fintech Frontier*, 20 Vand. J. Ent. & Tech. L. 129, 151 (2017).

[5] *See, e.g.*, Krispin v. May Dep't Stores Co., 218 F.3d 919, 923–24 (8th Cir. 2000); Beechum v. Navient Sols., Inc., No. EDCV 15-8239-JGB-KKx, 2016 WL 5340454, at *7 (C.D. Cal. Sept. 20, 2016); Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359, 1368–69 (D. Utah 2014); Hudson v. ACE Cash Express, Inc., No. 01-1336-C, 2002 U.S. Dist. LEXIS 11226, at *16 (S.D. Ind. May 30, 2002).

[6] *Hudson*, 2002 U.S. Dist. LEXIS 11226, at *16.

[7] *Beechum*, 2016 U.S. Dist. Westlaw 5340454, at *n 12.

[8] 85 Fed. Reg. 44223 (July 22, 2020).

national banks by relevant federal and state law.[9] If the bank fails to meet its obligations under federal law, the loan may be invalid, and at a minimum the bank faces the risk of enforcement actions from federal bank regulators and the possibility of fines, penalties, and other sanctions. The borrower receives the benefits of this federal consumer protection regime that governs bank loans. The fact that a national bank or federal savings association is in partnership with a nonbank entity does not materially change the characteristics or terms of the loan, the borrower's obligations, the bank's legal obligations, or the relevant federal consumer protection law that governs the loan. The borrower remains in the exact bargain he or she originally struck, regardless of the bank's partnerships. Therefore, there is no justification for altering the legal status and enforceability of a loan simply because a national bank is partnering with a nonbank entity. It would be unfair to vitiate the intent of the parties at the time of the contract when the terms of the contract and the protections given to the borrower remain wholly unchanged.

THE PROPOSAL IS ECONOMICALLY SOUND

Not only is the proposed rule clarifying when a national bank is a true lender fair, it is also economically sound. The ability of national banks and federal savings associations to partner with nonbank entities is an important aspect of modern credit allocation. These partnerships allow banks to extend credit to worthy borrowers and then move the credit risk off their books. This helps move the risk away from the federally insured deposit system and toward willing investors outside the banking system who understand and are willing to bear the risk. These partnerships allow banks to avoid concentration risk and can allow community and other smaller financial institutions to compete with larger banks, helping preserve these institutions.

Failing to clarify that banks are the true lender will hamper the ability of banks, especially smaller banks, to utilize the comparative advantages of their nonbank partners to increase their efficiency and provide better products and services to consumers. For example, many partnerships include not only the sale of the loan to a nonbank partner, but also the ability of the bank to leverage the nonbank partner's ability to provide superior technology in areas such as client identification, data analysis and underwriting, and loan servicing. This can result in the bank being able to offer a superior product to more customers compared to what it could provide by working alone.[10] While large banks can afford to develop these capabilities internally, smaller banks need partners, and the economics and regulatory reality of these relationships may require the ability of the bank to sell its loans to fully take advantage of the possibilities offered.

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[9] The OCC has acknowledged that national banks are bound by certain state laws, including but not limited to antidiscrimination law. *See* OCC, APPENDIX A: FEDERAL PREEMPTION OF STATE AND LOCAL FAIR LENDING AND MORTGAGE LENDING LAWS 3-4 (2010).

[10] For example, there is evidence that loans utilizing innovative underwriting techniques such as big data and machine learning can provide better pricing and be less discriminatory than traditional techniques. *See, e.g.*, Julapa Jagtiani & Catharine Lemieux, *Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information* 26 (Fed. Reserve Bank of Phila., Working Paper No. 17-17, 2017); Robert P. Bartlett et al., *Consumer Lending Discrimination in the FinTech Era* (May 2019) (UC Berkeley Public Law Research Paper). These techniques are likely beyond the means of a community bank but available via partnership. There is also evidence that bank partnerships facilitate greater access to credit in parts of the country that are underserved by traditional banks. *See* Julapa Jagtiani & Catharine Lemieux, *Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?* (Fed. Reserve Bank of Phila., Working Paper No. 18-13, 2018), Usman Ahmed et al., *Filling the Gap: How Technology Enables Access to Finance for Small- and Medium-Sized Enterprises*, 10 INNOVATIONS 35–48 (2015).

Failing to clarify that a national bank or federal savings association will be considered the true lender, and therefore failing to ensure that the loan will be consistently governed by the laws that apply to the bank over the course of its life, will harm the facilitation of credit as national banks, nonbank partners, and investors are hesitant to enter into these partnerships out of fear that the resulting loans may become invalid or unenforceable. Marginal borrowers (those who pose greater credit risks and therefore must be charged a higher interest rate) will likely face the greatest harm, since they most likely benefit from the increased efficiency brought by these partnerships and are most likely to be charged an interest rate above the interest rate cap set by the state in which the borrower resides.

There is evidence of this effect in the wake of the *Madden v. Midland Funding* decision, which, while it did not deal with the true-lender question directly, had a functionally equivalent impact.[11] After the *Madden* decision, funding for loans issued by banks in conjunction with nonbank "marketplace lenders" (a type of loan implicated by true-lender considerations) diminished significantly in the states within the Second Circuit owing to increased uncertainty about whether the loans issued and sold to nonbank partners would be subject to the law of the bank's home state (as allowed by federal law) or the borrower's state.[12] Consequently, credit available to borrowers shrank, especially for more marginal borrowers in the Second Circuit.

Additionally, concerns about the validity of a loan made by a bank in conjunction with a nonbank partner have forced changes to the structure of the loan to meet arbitrary regulatory thresholds, rather than being driven by economic efficiency or consumer-oriented innovation.[13] This inefficiency may result in higher costs, less desirable terms, or less credit extended, all to the detriment of the customer.

THE PROPOSAL PROTECTS CONSUMERS

The proposal helps address fears that such bank partnerships might harm consumers. The proposal expressly states that the lending bank is subject to all the requirements of federal law in making the loan.[14] This rule eliminates any possibility of banks merely "renting out" their charter to nonbanks for the purpose of evading borrower-state laws governing interest. Instead of being an absentee landlord allowing a third party to make all material decisions, the bank must meet the standards set for bank conduct by federal law and regulation for any loan with the bank's name on it, or any loan funded by the bank at the date of origination, regardless of who ultimately owns the loan. While a bank can get assistance from a partner in areas such as advertising, underwriting, and servicing, the bank must fulfill its obligations, exercise control over its partners, and bear regulatory risk for any decision made by the bank or its partners. While a bank may be able to sell its economic interest in the loan, it cannot shed its regulatory risk for the creation of the loan.

Consumers receive all of the protections guaranteed by federal banking regulation. They are not worse off by the partnership between the bank and the nonbank firm. Instead, because this type of relationship is permitted, the consumer receives all of the benefits that are created

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

[12] See generally Colleen Honigsberg, Robert J. Jackson Jr. & Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & ECON. 673 (2017).

[13] Knight, *supra* note 4, at 188.

[14] 85 Fed. Reg. 44225–27 (proposed July 22, 2020).

through the partnership between the bank and the nonbank firm, be they better products, services, or even terms.

Further, as discussed earlier, there is evidence that creating uncertainty in the enforceability of loans can lead to reductions in the amount credit available to consumers, with unfortunate results. Following the *Madden* decision, researchers found a significant reduction in both the number of loans made and the size of those loans.[15] The effect was particularly pronounced for high-risk borrowers, for whom the reduction of credit was the greatest.[16] There is evidence that this reduction in credit availability may have led to an increase in the number of personal bankruptcies.[17] Impeding bank partnerships can actually lead to less and poorer-quality credit available for potential borrowers, an outcome that would end up harming consumers. Clarifying that when a bank makes a loan it is the true lender would likely lead to greater consumer protection, not harm.

CONCLUSION

The OCC's proposal is fair, is economically sound, and protects consumers, and the OCC should finalize it. In doing so, the OCC can help restore clarity and certainty to credit markets, strengthen banks' ability to enter into partnerships, and improve access to credit to the benefit of banks, their nonbank partners, consumers, and society more broadly.

[15] Honigsberg, Jackson & Squire, *supra* note 12, at 675.
[16] *Id.* at 697–98.
[17] Piotr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* 3–4 (July 5, 2018) (working paper).