Sept. 3, 2020

Comments of the Consumer Law Advocates, Students, and Scholars (CLASS) Network on the Office of the Comptroller of the Currency's Notice of Proposed Rulemaking

Docket No. OCC-2020-0026

We, the undersigned, are members of the CLASS (Consumer Law Advocates, Students, and Scholars) Network. The CLASS Network brings together consumer-law-focused law school clinics, centers, and student organizations to share resources and ideas and to participate in important judicial and regulatory proceedings – like this one. Members of the Network are lawyers, legal academics, and students who teach, research, practice, and advocate for policy reforms in the area of consumer law. We are specifically interested in policies that affect markets for low-income consumers.

We write today in response to the Office of the Comptroller of the Currency's Notice of Proposed Rulemaking, Docket No. OCC-2020-0026, 85 Fed. Reg. 44223 (July 22, 2020) (Proposed Rule (Proposed Rule), opposing the rule.

We appreciate the opportunity to submit these comments for your consideration and are at your disposal should you wish to discuss any of these comments further.

I. Introduction

If enacted, the proposed rule would change the relationship between nonbank lenders and possible national bank or federal savings association partners by deeming the national bank or federal savings association to be the "true lender" if it was either "named as the lender in the loan agreement" or "funds the loan." 85 Fed. Reg. at 44223. We oppose the proposed rule because it will have significant, negative effects on borrowers, especially low-income borrowers. Low-income borrowers are more likely to use high-cost loan products, specifically payday loans, small-dollar installment loans and car title loans.[1] The rule will allow nonbank lenders to avoid state law that currently protects many of these consumers. The rule will give new life to the "rent-a-charter" schemes that preyed on consumers in the early 2000s – schemes the OCC itself acted to eliminate.

In addition, the rule runs counter to provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank") which prohibits the preempting of a state consumer protection law unless the law has "a discriminatory effect" on or "significantly interferes" with the powers of national banks. 12 U.S.C.25b(b)(1). As Professor Arthur E. Wilmarth has pointed out in his comments to the proposed rule, the OCC

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[1] S. Ilan Guedj, *Report Reviewing Research on Payday, Vehicle Title, and High-Cost Installment Loans, May 14, 2019, Bates Economic Consulting,* https://lawyerscommittee.org/wp-content/uploads/2019/05/Report-reviewing-research-on-payday-vehicle-title-and-high-cost-installment-loans.pdf at 6-8.

has failed to meet the basic requirements necessary before proposing such a sweeping preemption rule.[2]

For these reasons, we, the undersigned, oppose final enactment of this proposed rule.

II. The Rule Should Not Permit the Evasion of State Usury Laws

The rule threatens to overturn the well-established, effective, and historically unbroken regime of state oversight of consumer lending. "[S]upport for usury limits is built upon American history, tradition and culture."[3] For more than 200 years, states have regulated and prohibited usurious loans.[4] Indeed, states have historically been the only source of usury protection for their residents.[5]

The federal government, by contrast, has relatively scant experience with the regulation of small dollar lending. The only significant interest rate protection granted to consumers by the federal government protects just military personnel and their families.[6] It has been less than thirty years since the Supreme Court changed the landscape with its decision in *Marquette National Bank v. First Omaha Service Corp.,* 439 U.S. 299, 308 (1978*).*[7] *Marquette* allowed national banks to use the interest rate permitted by the location of their bank, as opposed to the location of the customer to whom the loan was grated.[8] This resulted in the dismantling of usury laws in some states across the country.[9] It is nevertheless notable that Congress recently decided that it is necessary to protect our troops by establishing an interest-rate ceiling on small-dollar loans. If there is a direction to move, according to Congress, it is in the direction of more regulation of small-dollar lenders, not less.

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[2] *See,* Arthur E. Wilmarth, *Comment Letter in Opposition to the OCC's Proposed "True Lender" Rule,* (August 11, 2020)*,* GWU Legal Studies Research Paper No. 2020-49, GW Law School Public Law Research Paper No. 2020-49, available at SSRN, http://ssrn.com/abstract=3673421

[3] Christopher L. Peterson, *"Warning: Predatory Lender"—A Proposal for Candid Predatory Small Loan Ordinances*, 69 Wash. & Lee L. Rev. 893, 896 (2012).

[4] *Id.*

[5] *See,* e.g., *Griffith v.* Connecticut, 218 U.S. 563, 569 (1910) (finding that usury laws fall "within the police power" of states); *Goleta National Ban v.* Lingerfelt, 2111 F. Supp. 2d 711, 716 (E.D.N.C.2002) (state has "a vital interest in protecting its citizens from predatory lending, usury, and other forms of deceptive trade practices"); *Kaneff v. Delaware Title Loans*, 587 F.3d 616 (3d Cir. 2009); *MacDonald v. Cash Call, Inc.,* 2017 WL 1536427 (D.N.J. Apr. 28, 2017). Madden *v. Midland Funding,* 237 F. Supp. 3d 130 (S.D.N.Y. 2017); *Pa. Dept of Banking v. NCAS of Delaware, LLC*, 948 A.2d 752, 759 (Pa. 2008) ("regulation of the rate of interest is a subject within the police power of the State").

[6] Creditors can charge no more than 36% for loans to servicemembers. Military Lending Act, 10 U.S.C §987. Also, active duty servicemembers are entitled to have their interest rates lowered to 6% pursuant to the Servicemembers Civil Relief Act. 50 U.S.C. §3937.

[7] *See also* Peterson, *supra* note 3, at 897.

[8] *Id.*

[9] Peterson, *supra* note 3, at 897-98.

The proposed rule, however, moves in the direction opposite to the one indicated by Congress. It allows nonbanks to charge whatever interest rates they choose simply by establishing a relationship with a national bank or federal savings institution. The proposed rule will revive the predatory "rent-a-charter" practices of predatory lending from the early 2000s. In 2003, John D. Hawke, Comptroller of the Currency, announced the OCC's enforcement action against People National Bank by explaining the harmful intent and effect of the "rent-a-charter" scheme. National banks, he explained, "essentially rent out their charters to third parties who want to evade state and local consumer protection laws."[10] Yet less than twenty years later, through this proposed rule, the OCC is incentivizing nonbank lenders to do just that.

The "rent-a-bank" scheme works similarly to the "rent-a-charter" scheme John Hawke was so concerned about in 2003. The nonbank – often predatory – lender takes a loan application from a consumer. It is immediately routed to a national bank that, under this rule, would now be considered the actual lender, rendering the loan free from state usury laws. The bank provides the funds for the consumer, but immediately sells the loan back to the nonbank lender, retaining a fee. The consumer pays the nonbank lender, often never realizing a third-party bank was involved. The national bank behind the scheme is essentially laundering the money for the nonbank lender, stripping the loan of any state law protections.

This proposed scheme is frighteningly similar to the actions of the OCC leading up to the subprime mortgage crisis – actions that were later directly and specifically rebuked by Congress in the Dodd-Frank Act. When states tried to curb the abuses of predatory lending, the OCC repeatedly stepped in to preempt state law protections. According to one Senate report, "the OCC and the OTS actively created an environment where abusive mortgage lending could flourish without State controls."[11] A witness, quoted in the report, had warned against the danger of OCC's preemption policy in 2004. "The OCC has not only done a tremendous disservice to hundreds of thousands of borrowers, but has also sown the seeds for future stress on the banking system."[12] That witness proved to be correct. The Financial Crisis Inquiry Report points specifically to the role of the OCC in protecting predatory lenders from state protections in the run-up to the Great Recession.[13] As former Assistant Attorney General of Minnesota Prentice Cox testified, instead of assisting states in enforcing consumer protection, the OCC actively fought against the states. Cox poignantly pointed out that the OCC "should have been on our side."[14] Unfortunately, the agency was not. As a result, the subprime crisis grew to become a world-wide, financial crisis.

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[10] News Release, Jan. 31. 2003, https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-6.html
[11] Senate Report 111-176, The Restoring American Financial Stability Act of 2010, Senate Report, April 30, 2010 at 17.
[12] *Id.* (quoting a warning given by Martin Eakes in 2004).
[13] Financial Crisis Inquiry Report (2011) at 13, 96, 111-113.
[14] *Id.* at 13.

It is true that the high-interest, small-dollar loans at issue in this rulemaking are unlikely to have the same systemic, crisis-causing effects that the OCC's preemption position had on mortgage lending. The OCC's proposed rule will, however, encourage predatory, nonbank lenders to circumvent state law in order to make high cost loans to consumers. For those consumers, the effects will cause a crisis.

We call upon the OCC this time – in the midst of an economic crisis causing financial vulnerability and desperation around the country – to be "on our side," the side of the American consumer.

A. Payday, title and other small installment loans present serious risks for vulnerable consumers

States have nearly universally recognized the potential harmful effect of small, high-interest loans on their citizens. 45 states and the District of Columbia now have some interest rate protections for small consumer loans.[15] Every interest-rate cap on small-dollar loans that has been subject to referendum or initiative has been approved, generally by overwhelming majorities – in red states, purple states, and blue states.[16] Three specific kinds of small-dollar loans have raised concerns for policymakers and advocates: payday loans, small dollar installment loans and car title loans. Payday loans are loans made, as the name suggests, to allow a consumer to get from payday to payday, typically two weeks.[17] The average APR is 391%, though it can be much higher.[18] Title loans have slightly longer terms, generally one month, with similar interest rates.[19] Recently, nonbank lenders have moved to longer term, small dollar installment loans. These too tend to have high interest rates and fees.[20]

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[15] NCLC, *State Rate Caps for $500 ad $2000 Loans (*Feb. 2020)*,* http://bit.ly/state-loan-caps.
[16] *See* Consumer Federation of America, Legal Status of Payday Loans by State, https://paydayloaninfo.org/state-information ("After permitting high-cost payday loans, **New Hampshire** capped payday loan rates at 36 percent annual interest in 2009. **Montana** voters passed a ballot initiative in 2010 to cap loan rates at 36 percent annual interest, effective in 2011. **Colorado** voters passed a similar ballot measure capping rates at 36% in 2018. **South Dakota** voters approved a ballot initiative in 2016 by a 75 percent vote to cap rates for payday, car title and installment loans at 36 percent annual interest. **Arizona** voters rejected a payday loan ballot initiative in 2008, leading to sunset of the authorizing law in 2010.") And in 2010 **Arkansas** voters approved a ballot measure limiting small dollar loans to a 17% APR.
[17] Guedj, *supra* note 1 at 2.
[18] *Id.* at 3.
[19] *Id.*
[20] *See supra* note 15.

Research has shown that the majority of payday loan borrowers are low-income.[21]They are disproportionately African American.[22] They are more likely not to have the "other financial safety nets that allow one to smooth consumption, such as credit cards or the ability to borrow money from family or friends, and they have a greater incidence of being denied credit in the past."[23] Payday borrowers are, in sum, the most vulnerable consumer borrowers. As a result, many of them get locked in an endless debt spiral, unable to pay back their loan and forced to borrower another to pay back the first.[24] Eventually, they default, further harming their credit.

Many of these consumers have no choice but to rely on these predatory products. They are already spending all of – or even more than all – of their income just to maintain basic needs.[25] As a result, the slightest unexpected expense can send them into a financial crisis. The lenders know this and prey on these unfortunate circumstances. As one court pointed out, "[t]he purpose of usury laws, from time immemorial, has been to protect desperately poor people from the consequences of their own desperation."[26] The proposed rule will further victimize these already vulnerable borrowers by removing this critical protection.

B. The proposed rule would overturn multiple state and federal true lender precedents

Courts have long evaluated usury claims by looking to the underlying substance of the transaction. Almost 200 years ago, Chief Justice John Marshall noted what is still true today: "The ingenuity of lenders has devised many contrivances, by which, under forms sanctioned by law, the [usury] statute may be evaded."[27] He went on to explain that courts must, therefore, look to the substance of the transaction and not purely the legal form.[28] Since then, courts have examined usury cases by carefully analyzing who is the "true lender."[29]

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[21] Guedj, *supra* note 1 at 6-7 (citing to Nathalie Martin & Ernesto Longa, *"High-Interest Loans and Class: Do Payday and Title Loans Really Serve the Middle Class?"* 24 Loyola Consumer L. Rev. 524 (2012); John Caskey, *"Payday Lending: new Research and the Big Question"*, Fed. Res. Working paper 2010); Amanda Logan & Christine Weller, *"Who Borrows From Payday Lenders? An Analysis of Newly Available Data"* Ctr for American Progress, Ma. 2009); Mary Caplan, Peter A. Kindle, Robert B. Nielsen, *Do We Know What We Think We Know About Payday Loan Borrowers? Evidence from the Survey of Consumer Finances*, 44 J. of Sociology & Social Welfare 19, 23-24 (2017) (surveying the literature findings).

[22] Guedj, *supra* note 1 at 7; Caplan, *supra* note 19 at 31.

[23] Caplan, *supra* note 19 at 31.

[24] Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products, Consumer Financial Protection Bureau, (2016) at 108, https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf

[25] Caplan, *supra note 19 at 31.*

[26] *Schneider v. Phelps*, 41 N.Y. 2d 238, 391 N.Y.S 2d 568, 359 N.E.2d 1361, 1365 (1977).

[27] *Scott v. Lloyd*, 34U.S.418, 446-47 (1835).

[28] *Id.*

[29] *See* Wilmarth, *supra* note 2 at 13.

For instance, courts have often looked at which party has the "predominant economic interest" in the transaction. In *CFPB v. CashCall, Inc,*[30] for example, the court examined a "rent-a-lender" arrangement in which the lender claimed preemption by virtue of its affiliation with a lender not subject to state law. In this case, the supposed lender was affiliated with the Cheyenne River Sioux Tribe rather than a national bank, but the intent of evading state interest rate caps was the same.[31] The lender funded the loans and immediately sold them to CashCall. The borrower paid CashCall.[32] The court determined that the lender had no real economic interest in the loans and, therefore, the true lender was CashCall.[33] Because CashCall assumed "all economic risks and benefits of the loans immediately upon assignment,"[34] it was the "true lender."

The arrangement in the CashCall case bears a disturbing and entirely non-coincidental resemblance to the payday "rent-a-charter" situations previously described. CashCall created this arrangement when it could no longer partner with a national bank to avoid state usury laws.[35] Yet the proposed rule ignores the obvious intent of evading state law, ignores the OCC's own precedent in disapproving of this sort of evasion, and instead adopts a standard that is all form and no substance. Instead of looking at the various prescribed factors to determine who is the "true lender," the rule creates a sweeping, one-size-fits-all response. Whenever a national bank "funds" a loan, state law is preempted. Clearly, the proposed rule reopens the predatory lending business model, not just to payday lenders, but to hundreds of other perspective predatory lenders hoping to avoid state usury laws.

The OCC defends the proposed rule by claiming – without citing to supporting evidence – that if a bank funds a loan as of the date of origination, the bank always has a "predominant economic interest in the loan and, therefore, has made the loan -- regardless of whether it is the named lender in the loan agreement." 85 Fed. Reg. 44225. This simply flies in the face of reality. In these "rent-a-bank" schemes, the lender is simply acting as a pass-through or conduit to the real lender, the nonbank. The proposed rule attempts to assure the public by citing the ways in which the OCC protects consumers and has "cautioned banks about lending activities that may be considered predatory, unfair or deceptive." 85 Fed. Reg. 44226. Again, history tells us otherwise.[36] The OCC has utterly failed in the recent past to protect the public from predatory practices. It has no authority to regulate the nonbanks that will be involved in these transactions.

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[30] 2016 WL 4820635 (C.D. Cal., Aug 31, 2016).
[31] *Id.* at *5-6.
[32] *Id,* at *2.
[33] *Id.*at *6.
[34] *Id.*
[35] *Id. at *1-2,*
[36] *See supra* note 13; *see also* Alan White, Carolina Reid, Lei Ding & Roberto G. Quercia, *The Impact of State Anti-Predatory Lending Laws on the Foreclosure Crisis*, 21 Cornell J. of Law and Pub. Pol'y (2011) (empirical study showing the positive effects of state anti-predatory laws and suggesting that the OOC's federal preemption negatively impacted consumers in the run up to the Great Recession).

The banks will be in and out of these loan transactions so quickly that it is unlikely to have any effect on their bottom line or raise the interest of regulators.

III. The Proposed Rule Violates the Dodd-Frank Act

In the Dodd-Frank Act, Congress took specific steps to prohibit the kind of blanket preemption that the proposed rule envisions. As mentioned, the Financial Inquiry Report documented the ways in which the OCC's preemption rules contributed to the Great Recession.[37] Knowing this, Congress took clear and deliberate steps to restrict the OCC's ability to again create such broad, destructive preemption. As mentioned in the Senate report on the issue, the Dodd-Frank Act returned the standards for federal preemption to those articulated by the Supreme Court in *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).[38] The resulting statute specifically invokes *Barnett* in stating that a "State consumer finance law" is preempted by federal law only if it "prevents or significantly interferes with the exercise by a national bank of its powers." 12 U.S.C. 25b(b)(1)(B). The Act goes on to instruct the OCC to make these determinations on a "case-by-case basis." *Id.* Yet the proposed rule does just the opposite. There was no case-by-case analysis of the impact of this rule. There was no finding of how or why the OCC determined that state laws were "significantly" interfering with national banks. In fact, the commentary to the rule fails to present any evidence or analysis whatsoever on the subject.

Instead, the OCC apparently relies exclusively on deference under *Chevron USA, Inc.*[39] as support for its sweeping and general intent to fulfill "its responsibility to resolve ambiguities in the Federal banking laws." 85 Fed. Reg. 4424. The startling claim that *Chevron* deference permits an agency to act in contravention of clear congressional intent is not one likely to survive judicial review. The Dodd-Frank Act sets out a much different standard of review than the deference discussed in *Chevron.*[40] In fact, Dodd-Frank specifically rejects the field preemption that the proposed rule claims. 12 U.S.C. §25b(b)(3)(B). In proposing this broad pre-emptive rule, the OCC apparently ignores Dodd-Frank and fails to make the preemption decision on a case-by-case basis as required. The agency is again claiming complete field preemption, despite Congress's clear rejection of that position.

While most of this comment has focused on the proposed rule's preemptive effect on state usury laws, it should be noted that the principles stated in the rule are broad enough to justify the preemption of all state consumer protection laws. Simply by laundering its loans through a

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[37] *See* Financial Inquiry Report, *supra note 13.*
[38] Senate Report, *supra* note 11 at 175-76.
[39] 85 Fed. Reg. 4425, *supra* note 18.
[40] Jared Elosta, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate,* 89 N.C.L. Rev. 1273, 1301-02 (2011).

national bank, a nonbank lender could claim that no state lending law applies to its loans. This is a truly frightening prospect for consumers.

In *Phishing for Phools: The Economics of Manipulation and Deception,* Nobel Prize winning economists George Akerlof and Robert Shiller persuasively point out that "free markets" are a "two-edged sword."[41] "[C]ompetitive markets," they observe, "by their very nature spawn deception and trickery, as a result of the same profit motives that give us our prosperity."[42] Therefore, robust consumer protection laws and enforcement of those laws are necessary and inherent in a free market system. Yet if this rule becomes final, it will create the kind of predatory lending that Akerlof and Shiller decry. The rule will actively prevent the principal regulators of nonbank lenders from acting to prevent the harms that inevitably result from small-dollar lending. Nonbank lenders will have gained license to avoid state consumer protection laws, simply by adopting a national bank as partner in crime.

We urge the Comptroller of the Currency not to let this happen, and instead to withdraw the proposed rule.

Respectfully submitted,

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[41] George A. Akerlof & Robert J. Shiller, Phishing for Phools (Princeton, 2015) at 165.
[42] *Id.*
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UC Irvine Consumer Law Clinic, on behalf of our clients
USC Consumer Advocacy and Protection Society
Center for Consumer Law and Education (Jonathan Marshall) & WVU Consumer Law Student Group