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## STATES CHALLENGE OCC TRUE LENDER RULE

Eight states' Attorneys General have filed a lawsuit against the Office of the Comptroller of the Currency ("OCC") to challenge the validity of the OCC's recent true lender rule based on violations of the Administrative Procedure Act. *People of the State of New York, et al. v. OCC*, No. 21-cv-00057 (S.D.N.Y. Jan. 5, 2021). The OCC's true lender rule addresses when a national bank or federal savings bank makes a loan under federal banking law in a partnership with a nonbank. See our prior ALERT dated Oct. 30, 2020. The OCC's rule became effective on December 29, 2020.

The Attorneys General of California, Colorado, the District of Columbia, Massachusetts, Minnesota, New Jersey, New York and North Carolina claim that the OCC's true lender rule is unlawful for the following reasons:

- 1. The statutes relied on by the OCC to issue the true lender rule do not authorize the OCC to preempt state laws.** The complaint claimed that the three federal banking statutes (12 U.S.C. §§ 24, 371, 1464(c)) that the OCC interpreted to issue the true lender rule are not ambiguous and do not authorize the true lender rule. The Attorneys General alleged that the OCC is trying to re-write federal law. The complaint asserted that the strong assumption against preemption of states' historic police powers should apply in this case because interest rate caps and the true lender doctrine are among states' historic police powers.
- 2. The true lender rule constitutes an unreasonable interpretation of federal law.** First, the complaint stated that the true lender rule radically deviates from the established true lender analysis "applied by courts for centuries." According to the Attorneys General, in determining whether a loan is usurious, the law has historically looked to the substance of the loan transaction, not its form, and factfinders carefully scrutinize transactions to see which party is the "true lender" of the loan *usually* looking to see which party had the predominant economic interest. The complaint also claimed that the true lender rule distorts federal law by allowing nonbanks to enjoy the benefits of National Bank Act ("NBA") preemption via rent-a-bank arrangements without the nonbanks having to submit to oversight by the OCC. Courts have held that the NBA does not apply directly to nonbanks except in certain circumstances.

- 3. The OCC failed to comply with provisions of the Dodd-Frank Act intended to constrain preemption determinations by the OCC.** According to the complaint, the OCC failed to comply with the substantive and procedural requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that apply when the OCC determines that state consumer financial laws are preempted. See 12 U.S.C. § 25b. The Attorneys General reasoned that Section 25b applies to the true lender rule because (i) the federal rule preempts state interest rate caps and true lender doctrines and (ii) state rate caps and true lender doctrines are "state consumer financial laws" under Section 25b. The Attorneys General argued that the OCC cannot show that state true lender laws and interest rate caps applied to nonbank lenders "prevents or significantly interferes with the exercise by a national bank of its powers," a substantive finding that is required by the Dodd-Frank Act when the OCC makes a preemption determination.
- 4. The true lender rule reverses longstanding OCC opposition to rent-a-bank schemes with no reasoned explanation from the OCC.** The Attorneys General boldly claimed that the true lender rule "endorses sham arrangements" between nonbank lenders and national banks under which the national bank has no meaningful involvement in the marketing, originating or underwriting of the loans, nor the predominant economic interest in the loans. The complaint recited the OCC's historic opposition to rent-a-bank arrangements.
- 5. The OCC's reliance on its "robust" oversight to prevent predatory lending is undermined by the OCC's recent embrace of predatory lenders.**
- 6. The true lender rule is not entitled to deference.** According to the Attorneys General, the Dodd-Frank Act established that the validity of OCC rules that preempt state laws must be assessed with a heightened level of scrutiny (*i.e.*, *Skidmore* deference) instead of the *Chevron* deference standard that generally applies to agency rulemaking.

The complaint also criticized the OCC for the speed at which the OCC reviewed the approximately 4,000 comments that it received on the proposed rule and finalized the true lender rule after the close of the rulemaking comment period.

The OCC has already addressed many of the arguments posed by the Attorneys General in the supplemental information

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accompanying the final true lender rule and in the OCC's Interpretative Letter No. 1173 (addressing the applicability of the preemption standards and procedural requirements in Section 25b). See our prior ALERT of Jan. 6, 2021.

How the incoming Biden Administration will handle this litigation and litigation challenging the OCC's so-called "*Madden-fix*" rule going forward is uncertain. One impetus for the OCC's rules was Congress' inability to resolve the "predatory lending" problem in crafting federal legislation to address these issues. The Biden Administration could be more sympathetic to the concerns raised by the Attorneys General and work to find a different path forward than through the courts. For now, this lawsuit is another example of the continuing tensions between federal and state regulation of financial services. □

✧ *Mike Tomkies and Susan Seaman*