TESTIMONY OF ATTORNEY GENERAL JOSH STEIN
REGARDING OCC TRUE LENDER RULE
TO SENATE BANKING COMMITTEE
APRIL 28, 2021

Mr. Chairman and members of the Committee, my name is Josh Stein, the Attorney General of North Carolina. I am pleased to have this opportunity to discuss the OCC's so-called True Lender Rule. This rule, if not reversed, provides a get-out-of-jail-free card to predatory lenders who violate state laws limiting interest rates and fees on consumer loans.

Many states set rate caps on consumer loans. For instance, in my home state of North Carolina, the maximum legal rate for consumer loans under $4,000 is 30%. These state consumer protection lending laws enjoy broad and bipartisan support, not only in North Carolina but across the country. For example, in the 2020 election, more than 82% of Nebraska voters approved a ballot measure to cap interest on payday loans at 36%. South Dakota voters approved a similar measure in 2016. Many of these lenders in our states are licensed, well-regulated, and compliant with state usury laws.

However, for as long as states have protected their resident borrowers from predatory lenders, those lenders have sought to evade state laws. Greed is a powerful motivator. One of their favorite ruses in recent decades has been to dress up the paperwork of their loans to make them look to be made by an entity exempt from state usury law, such as a national bank regulated by the OCC.

The courts have long recognized and outlawed these subterfuges that put form over substance. A longstanding legal principle, dating as far back as a 1835 U.S. Supreme Court opinion written by Chief Justice Marshall, demands an "examin[ation] into the real nature of the transaction" to determine whether a loan violates usury laws.

Many states including my own have incorporated Chief Justice Marshall's reasoning into their state law through the "true lender" doctrine (or sometimes called the "de facto lender" doctrine). It is a principle of state law that typically looks to whether a predatory lender retains the "predominate economic interest" in the loan to determine whether the predatory lender is the loan's true lender and therefore must comply with state rate caps.

North Carolina and other states have relied on the "true lender" doctrine to combat the illegal schemes of modern predatory lenders. North Carolina has a long history of strong laws and vigorous enforcement against payday lending. For a brief experimental period, from 1997 to 2001, North Carolina law allowed payday loans, and our state became home to 10% of the payday loan storefronts in the nation with a heavy concentration in neighborhoods of color and near military bases. During that time period, we learned firsthand the economic damage these loans inflict on working families. The median loan was for $244 for a period of 8-14 days at an APR of 419%. The average borrower got more than 8 loans from the same store, and one out of seven borrowers took out more than 19 loans per year. These loans were not a source of occasional credit as their marketing suggested but rather a debt treadmill from which borrowers

had trouble escaping; for a person struggling to keep their head above choppy financial waters, the loans were not a life preserver but an anvil.

Let me tell you briefly about Arthur Jackson (not his real name), a warehouse worker and grandfather of 7, who lives in Raleigh, NC, went to the same Advance America payday store for over 5 years. He got a single $200 loan, that was later increased to $300. Advance America flipped the same loan over 100 times, collecting $52.50 for each transaction, while extending him no new money. He ended up paying interest of over $5,000 for the loan, fell behind on his mortgage, and had to file for bankruptcy to save his home.

Lisa Terry, from Winston-Salem, NC, was a single mother making less than $8 an hour. She went to a payday store and got a $255 loan. Two weeks later, like so many borrowers, she didn't have the funds to pay it off, so she renewed or "rolled over" the loan. She paid renewal fees every 2 weeks for 17 months—paying $1254 in fees alone—without paying down the loan. She thought she was getting new money each time, not realizing that she was simply borrowing back the $300 she had just repaid. She said, "I felt like I was in a stranglehold each payday. After a while, I thought, 'I'm never going to get off this merry-go-round.' I wish I'd never gotten these loans."

Finally, Anita Monti, a 61 year old grandmother from Garner, made $9 an hour working second-shift at computer hard drive manufacturer. She wanted to buy her five grandchildren presents for Christmas, but she was living paycheck to paycheck. She went to an Advance America store and borrowed $300, less a $45 fee. In two weeks, she didn't have the money she owed, and her electric bill was due. So, she borrowed another $300, not realizing it was the same $300 over again. Only after getting a raise to $12 an hour and scrimping on food was she able, a year later, to pay the almost $2,000 in fees she paid week after week to get that $300 loan. As she said, "I needed the cash to get through the week. It didn't cross my mind that I was borrowing back my own money."

Due to the exorbitant interest rates of the loans and patterns of harmful, repeat borrowing that buried in debt thousands of North Carolinians like Arthur, Lisa and Anita, North Carolina's legislature allowed the law to sunset in September 2001. After the sunset, most payday lenders complied with the law and closed their doors. However, others looked for ways to circumvent North Carolina law through subterfuges, including rent-a-bank schemes. In particular, several national payday lending chains, including ACE Cash Express and Advance America, reached out to a few rogue national and state-chartered banks [including Goleta National Bank, Peoples National Bank of Paris (Texas), Republic Bank & Trust (of Kentucky) and First Fidelity Bank of Burke (South Dakota)] to which North Carolina's interest rate caps did not apply.

The banks' names were placed on the loan documents identifying the banks as the lenders, and the payday lenders continued making loans at sky-high interest rates of up to 521% to North Carolina consumers. The payday lenders contended, based on the loan documents, that they were no longer lenders – and that they were instead the "marketing, processing, and servicing agents" of the banks. Very notably, the payday lenders only used these "rent-a-bank" schemes in states like North Carolina that prohibited payday lending; in other states that allowed these high-rate loans, the payday lenders made the loans in their own names.

The North Carolina Attorney General's office under then Attorney General, now Governor, Roy Cooper took action against these schemes. I directed the Consumer Protection Division at that time. We asserted that the payday loans were covered by the true lender doctrine, which has been an integral part of North Carolina law since the 1800s. In February 2005, together with the Office of the North Carolina Commissioner of Banks, we brought an enforcement action against Advance America, which had continued its rent-a-bank arrangements.

In December 2005, the Commissioner of Banks held that Advance America was, in fact, engaged in the business of lending in North Carolina and was therefore subject to North Carolina usury law. Advance America stopped making loans in North Carolina. Subsequently, in March 2006, three other large payday lending chains, Check Into Cash, Check 'n Go, and First American Cash Advance, all of which had used out-of-state banks, also agreed to stop making payday loans in North Carolina.

North Carolina is by no means alone in protecting borrowers; other states have also relied on the true lender doctrine, as adopted in their state's common law, to stop payday lenders from using sham rent-a-bank schemes to evade states' interest rate laws. Examples of states that have taken action against rent-a-bank schemes in the last two decades using the true lender doctrine include, among others, Colorado, the District of Columbia, Georgia, New York, Ohio, Pennsylvania, and West Virginia. In each of these cases, the *sole* purpose for the payday lenders' entering into arrangements with the banks was, or is, to make loans to our states' residents at rates that are unlawful. There is no other purpose, because these lenders can, and do, make loans in their own name in states where they can—thus, these "rent-a-bank" arrangements are a blatant sham to evade state laws.

The OCC's new, so-called True Lender Rule will upend states' ability to protect their people. In fact, calling it the "True Lender Rule" is an upside down farce; it is more accurate to call it the "Fake Lender Rule" because it overturns the true lender doctrine developed by states. It allows predatory lenders to avoid state rate caps by slapping the name of a national bank on the loan's paperwork. This is literally taking the paper form and elevating it over the loan's substance. Under the rule, it does not matter that the predatory lender in a rent-a-bank scheme retains the "predominate economic interest" in the loan.

The OCC, through the Acting Comptroller, not only rammed through the Fake Lender Rule one week before the 2020 election, but it did so unlawfully. The OCC radically exceeded its statutory authority in issuing the rule. Although the OCC purports to be interpreting portions of three federal banking laws, none of them authorize rent-a-bank schemes or give the OCC authority to preempt the state law true lender doctrine.

The rule is also unlawful because the OCC ignored the centuries of court decisions recognizing and refining the true lender doctrine. The OCC's interpretation as set forth in the rule is unreasonable because it supplants well established court precedent established over centuries with an artificial and unprecedented standard. Reputable lenders submitted comments to the OCC warning the rule may create legal confusion for various types of standard lending

arrangements, but the OCC refused to address those concerns. Indeed, the OCC has never identified a single court or regulator that has used the standard it adopts in the rule.

The rule's endorsement of predatory lenders' ruses unlawfully ignored the OCC's own historical opposition, under the Clinton, Bush, and Obama Administrations, to rent-a-bank schemes and to the prospect of abusive, triple-digit interest-rate loans being made to financially distressed consumers in states that expressly forbid such loans. In the early 2000s during the Bush Administration, consistent with its guidance, the OCC took action against at least four national banks that had entered into rent-a-bank schemes with nonbank payday lenders; the OCC's orders required the national banks to terminate their partnerships with the payday lenders and to cease making the loans. And, as recently as 2018, in small dollar loan guidance the OCC declared that it "views unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)." However, shortly before promulgating the Fake Lender Rule, the OCC inexplicably withdrew that guidance and is now implicitly, if not explicitly, supporting rent-a-bank schemes with this new rule.

This new rule is galling not only because it ignores court and administrative precedent, but also because the OCC flouted the commands of Congress in finalizing it. In the Dodd-Frank Act, Congress required the OCC to adhere to strict procedural requirements before preempting state consumer protection laws to prevent the OCC from repeating its horrendous record on preemption that led to the Great Recession. But in issuing the Fake Lender Rule, the OCC refused to comply with the procedural requirements mandated by Congress.

State attorneys general from California, New York, Colorado, the District of Columbia, Massachusetts, Minnesota, New Jersey, and North Carolina filed a lawsuit in the Southern District of New York challenging this rule. We are optimistic about our ability to reverse the rule through litigation.

That said, I urge Congress to exercise its power under the Congressional Review Act to reign in a rogue OCC that believes it can disregard Congressional mandates. The congressional review process provides a far more straightforward means to reverse the Fake Lender Rule than litigation and the potential years it will take to secure a final court ruling. I am pleased that a bipartisan group of 25 Attorneys General, including General Rutledge of Arkansas, General Peterson of Nebraska, and General Ravnsborg of South Dakota, recently urged Congress to disapprove this new rule under the Congressional Review Act because it will facilitate predatory lending in our states.

Protecting our constituents is our highest calling. Playing a small role in running out of my state the payday lenders that abused hard-working people like Arthur, Lisa, and Anita is something I take immense pride in. As Senators, you have the authority to help people like them all across this country. It is an awesome power, and I ask that you exercise it.