# Consumer Finance Monitor (Season 3, Episode 29): Update on Recent Non-COVID-19-Related Consumer Financial Services Legal Developments

Speakers: Alan Kaplinsky and Chris Willis

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host today, Alan Kaplinsky, and I lead the Consumer Financial Services Group at Ballard Spahr. And I'm very pleased to have as... I guess we can call you a guest today, Chris, although you're a very integral part of our team. Happy to have Chris Willis with us today. We're going to do something a little bit different today than we typically have done. We're instead focusing on one particular important recent development. We're going to run through a bunch of things. You could call it a potpourri of issues.

Alan Kaplinsky:

They will have only one thing in common, and that is they're not going to deal with COVID-19. Our feeling being that there has been so much talked about and written about COVID-19 by the general media, by our firm. We have our COVID-19 resource page, our blog also called Consumer Finance Monitor. And we have really, I think, done a very thorough job dealing with COVID-19. But part of the problem that Chris and I have identified is there has been so much focus on COVID-19. I don't mean this in a pejorative way. It has sucked up, I won't say all the air, but a lot of the air in the room. And so people have ignored some other topics that ordinarily would get a great deal of focus if we weren't living through a pandemic. Anyway, welcome, Chris. Chris chairs our Consumer Financial Services Litigation Group and is the deputy practice leader of our entire Consumer Financial Services Group. Welcome, Chris.

Chris Willis:

Yeah, it's great to be here. Thanks, Alan.

Alan Kaplinsky:

Okay. We're going to talk about a lot of things today, but I think no better thing to start off with than a discussion of the Seila Law case, the US Supreme Court decision which came down recently holding that the CFPB was unconstitutionally created by virtue of the fact that the president lacked the ability to terminate the director of the CFPB without cause. And the CFPB essentially, in a five to four opinion, held that the statute was unconstitutional, but in a seven to two vote severed the offensive language or redlined it from the statute so that the net effect is that the president, whoever that might be, be it President Trump, or if it turns out to be President Biden, can remove the director for any reason at all.

Alan Kaplinsky:

Chris, what I want to focus on is the issue that really, I think, is of greater importance than the actual opinion in the case. And that is what are the ramifications of the opinion? Do you think the opinion might have a rippling effect and might affect either other regulations that the CFPB has issued in the past? Do you think it might affect regulations that are, let's call it, in process like the debt collection regulations? And also, what about prior consent orders and ongoing investigations and ongoing enforcement litigation involving the CFPB? I know that's a lot I gave you to think about, but your reaction to that.

Chris Willis:

Yeah. I think my belief is that it is unlikely to have any effect on past CFPB actions. There are a couple of reasons why I think that. One of them is let's look back at what then Judge Kavanaugh did when he was on the D.C. Circuit in the PHH case.

Remember, that was the first case where we got an opinion on the CFPB constitutionality and the reasoning and the results in Judge Kavanaugh's panel decision, which was later subject to an en banc rehearing and reversal by the D.C. Circuit. But nevertheless, that opinion that Judge Kavanaugh wrote while he was on the D.C. Circuit, found the for-cause removal aspect of the statute to be unconstitutional. And the remedy was to sever the offending language and make the director removable at will, shockingly similar to what the whole Supreme Court just did, with now Judge Kavanaugh as a member of the court.

Chris Willis:

But let's think about what the aftermath of it was. What was the actual mandate in the PHH case from the panel's point of view? The panel opinion was going to have vacated the CFPB's decision. It was an administrative enforcement action because there was a RESPA error in there as well as you'll recall, but then send the case back to the very same CFPB with the very same director, which was then Richard Cordray, to reevaluate the decision on the merits with respect to the RESPA issue. The court didn't say the enforcement action is null and void, the court didn't say nothing that the agency has ever done is now null and void. It was being vacated because of an error in applying RESPA and the exact same CFPB director was then going to be... according to the D.C. Circuit opinion that Judge Kavanaugh wrote, was going to then render a decision on the case, on remand.

Chris Willis:

And so that tells us that at least Judge Kavanaugh believed that the logical implication of his position was not to dismantle the agency or undo things that had done or strip it of power to take action on a going forward basis, but rather to leave the agency functioning just as it was before. And I think the seven to two majority on the severability issue, I think speaks to a desire on the behalf of the Supreme Court to set things right on a going forward basis and make the director removable at will and therefore more subject to political control than was the case under the original incarnation of Dodd-Frank. But there seems to be a great resistance to upsetting the applecart and undoing the agency's work.

Chris Willis:

So the idea of saying, well, for example, the qualified mortgage rule was enacted by the CFPB before the director was known to be removable at will by the president, so now that rule's out the window, seems to me a crazy result. That doesn't seem likely to be within the contemplation of the Supreme Court. And likewise, someone who entered into a consent order with the agency, I mean, it was by consent. What right does a party who entered into a consent order by consent have to then say, "Oh, well, now this is not valid anymore"? And the thing is, from a consent order standpoint, these arguments about the CFPB's potential unconstitutionality have been out in the public for a long time. The PHH decision, the original panel decision was years ago. And so the argument would be made, "Well, you entered into the consent order with the full knowledge of this issue, so you're now stuck with your choice." So I think the idea of undoing a consent order is very, very unlikely. And then with respect to things... Go ahead, Alan.

Alan Kaplinsky:

Yeah. But let me ask you, why do you think the Supreme Court remanded Seila Law back to the Ninth Circuit to decide whether to nullify the CID or not? Couldn't they have dealt with that and ended the case?

Chris Willis:

Well, it wasn't the question on which they granted cert. So it was neither briefed nor argued to the court. I think the Supreme Court generally doesn't want to decide issues in a vacuum without them having been developed in the court beneath. And so I think it was a desire to handle it in that way, which is the way the court has done things for many years. And so we'll see what the Ninth Circuit does. But my guess is the Ninth Circuit will say, "The CID is still valid, you have to comply with it," and then cert will be denied on that decision by the Supreme Court, is my guess.

Alan Kaplinsky:

Yeah. I would agree with you certainly on Seila Law because, look, if it turns out that they were to invalidate the CID, what would be wrong with the CFPB issuing a new CID today?

Chris Willis:

Correct.

Alan Kaplinsky:

I mean, my guess there could be a statute of limitations issue. Maybe it couldn't cover as much territory, but it would seem that there's certainly a way around.

Chris Willis:

Correct. Well, and not only that, but the whole idea is that the for-cause removal provision is severable according to seven justices on the Supreme Court. Severable means that that piece is deemed unconstitutional without effecting the validity of the whole rest of the statute. Well guess what? The CID provision isn't another part of the statute from which this is now been severed. So why would we hypothesize the for-cause removal issue would invalidate the bureau's authority to issue civil investigative demands when the Supreme Court just told us it was severable?

Alan Kaplinsky:

Right. So the one area that I know I've been debating with some of our colleagues, in fact we've done a blog about it, is the impact that the decision might have on the very convoluted state of affairs with respect to the Small Dollar Lending Rule, where there's a lawsuit pending in federal court in Texas that challenged the validity of that rule, both based on the constitutionality of the CFPB and based on the Administrative Procedures Act and a variety of other challenges in that case has been stayed and remain stayed.

Alan Kaplinsky:

But might that be something where the judge in Texas might very well say, "Hmm, here's an easy out right now instead of... Everybody's waiting for the final CFPB or Small Dollar Lending Rule to be finalized that hasn't been finalized"? CFPB thinks it's unconstitutional and they don't like that rule. So they might very well agree with the plaintiff in that case that the court ought to throw the old rule out, meaning that the ability to repay is gone. In other words, it could be a simple way out of what right now presents itself as something that's just could go on for a very lengthy period of time with no clear end result.

Chris Willis:

Yeah. But if the CFPB... Is it possible for the bureau to go to that court and advocate a basis for the Payday Lending Rule, the Short-Term Lending Rule to be invalidated, that doesn't affect all the other rules that it has created since its inception, like qualified mortgage or the loss mitigation rules in mortgage servicing, for example? And I think the bureau wants to keep those.

Alan Kaplinsky:

Oh, yeah. Not only the bureau, but the industry wants to keep all of those rules.

Chris Willis:

Correct. So if a rule is invalid because of the single director removable only for cost structure, how is that then limited to the Short-Term Lending Rule? It's not. And so I have a hard time thinking the bureau would go into that court and say, "Oh, aha, here's my easy way out of the small dollar lending problem," because then they've really quite literally thrown out the baby with the bath water.

Alan Kaplinsky:

Yeah. Well, we'll see what happens there. It's going to be very interesting. Let's move on to another topic. I know a topic very near and dear to your heart, and that is fair lending, and want for you to tell our listeners what the FTC and DOJ... where things stand with their enforcement action against auto dealers.

Chris Willis:

Yeah, it's been very interesting because the most recent incarnation of fair lending enforcement related to auto finance was what we saw from the CFPB between about 2013 and 2016 with the various consent orders against banks and manufacturer captive finance companies dealing with dealer finance charge participation. And then that issue went quiet after the congressional override of the bureau's bulletin on that issue and then the change in administration also. We hadn't really seen much in the way of fair lending activity on the dealer front until pretty recently. And now recently, we've had two dealer cases right in a row with one another, the first from the Federal Trade Commission and then the second one from the Department of Justice, which just came out much more recently even than that.

Chris Willis:

And so historically, you have seen some cases against dealers from the Department of Justice, for example, like the Pacifica case is a very famous older one from the 1990s. But you hadn't seen any in a long time. And auto dealers are, of course, not subject to CFPB jurisdiction. So the FTC and the Department of Justice are the only federal regulators that can pursue them for violations of the Equal Credit Opportunity Act. I just find it interesting that even under a Republican administration, you've got both of those regulators now in close proximity to one another in time filing fair lending enforcement actions against two different auto dealers for fair lending violations. What it says is the heat may be coming back to auto dealers on the fair lending front, even though the dealer participation issue at the finance company level has exited the scene starting in 2016, at least temporarily.

Alan Kaplinsky:

Chris, the cases that you're referring to, do they deal with outright discrimination? You said they don't deal with disparate impact. What exactly do they allege?

Chris Willis:

Both of them do allege actual disparate treatment, intentional discrimination, where both dealerships were alleged by the respective regulators to have had a practice of treating people differently on the basis of, say, race or ethnicity, which I think was the allegation in both cases and giving them different terms, different down payments required, different pricing on retail installment contracts, et cetera. And so they weren't disparate impact cases. They were disparate treatment cases.

Alan Kaplinsky:

Okay. Moving to the topic of disparate impact, where does that stand right now? There's a lot of confusion over the viability of that theory of liability. Is it dead or is it just dormant right now?

Chris Willis:

It's definitely not dead and I don't think it's dormant either. It's just not visible at the moment. So let's recap where we are on disparate impact. When you had Mick Mulvaney appointed as the acting director of the CFPB, there were about three communications from the bureau publicly that suggested that the bureau was "reevaluating the use of disparate impact to be more in line with Supreme Court precedent," which we read to be the inclusive communities case. And so there was some thought that the CFPB might do something from either a guidance or a rulemaking standpoint to either reign in disparate impact, similar to like the HUD rulemaking that's in process right now, or to just say outright, "There is no disparate impact under the Equal Credit Opportunity Act."

Chris Willis:

Notably, you have not seen any statement like that since Kathy Kraninger took over as the director of the CFPB. All those statements were made under Mick Mulvaney's tenure as acting director. We have not seen another peep in that direction from the bureau since Ms. Kraninger took over as director. And meanwhile, although there have been no disparate impact enforcement actions that I'm aware of from the CFPB during the last several years, the bureau is still applying disparate impact in supervisory matters. We have clients who have active matters in supervision that are wholly related to disparate impact, and the doctrine is being applied just as it always was with the same kinds of regression analysis, the same kinds of thresholds for what constitutes actionable discrimination, et cetera. And so I think given what is going on in supervision, we can't even say that disparate impact is dormant. It is actively in use by the bureau in a way that is not very public because it's in supervision, but nevertheless is very real for the industry.

Alan Kaplinsky:

If there are, as you indicate, a number of supervisory matters pending, eventually, they will percolate up to enforcement. Won't they? If you can't get it resolved at the supervisory level, then supervision will recommend that some enforcement action be taken and they have a committee that decides what to do. So isn't this eventually going to come to a head?

Chris Willis:

Not necessarily because the supervision matters that I'm familiar with are being resolved in supervision without the need for escalation to enforcement. And these are supervisory matters that even go so far as to require remediation and payments, actual restitution to consumers, but they are staying in supervision, they're not going to enforcement. And so the ones I'm aware of will not come out into enforcement. The one other thing I would mention Alan is there are state regulators who have an interest in disparate impact too. The New York Department of Financial Services is a particular one. New York DFS was conducting disparate impact fair lending examinations of auto finance companies over the last couple of years. And there's no reason to believe that the New York DFS interest in fair lending has waned any. We've seen them raise fair lending issues in examinations that we're participating in right now that are purely disparate impact issues, dealing with scoring models and things like that.

Chris Willis:

So there are state regulators that are also interested in disparate impact, even if it is perceived, and I believe incorrectly so, that the federal regulators have become less interested. And let's not forget Alan, remember Andrew Smith's blog, who's the director of the Bureau of Consumer Protection at the FTC, he wrote a blog recently about the use of alternative data in credit underwriting models, and specifically highlighted the disparate impact risk from the FTC's perspective, and stating that the FTC would take action if it saw a disparate impact in alternative data scoring models. And the joint inter-agency statement from the FDIC, OCC, Fed and CFPB on the use of alternative data in credit underwriting also made the point about disparate impact in scoring models from alternative data. So I don't think there's any evidence from which we should conclude that disparate impact is dead or even dormant.

Alan Kaplinsky:

Let's turn to another fair lending related issue, Chris, is one that has gotten a lot of attention in really the last six months or so. And that is the HUD Google announcement regarding ad targeting on social media.

Chris Willis:

Yeah. What's interesting about this one is it's not Facebook. A lot of the action on ad targeting that has existed up to this date has been involving Facebook. You had the Washington attorney general consent order with Facebook, you had the National Fair Housing Alliance lawsuit against and then settlement with Facebook, you had Facebook come out with its special ad audiences feature about a year and three months ago, you had the HUD charge of discrimination against Facebook, which is still ongoing. At the time that that charge happened, which was in March of 2019, as I recall, HUD also announced it was investigating Google and Twitter for similar ad targeting issues under the Fair Housing Act. That then sat for over a year without any public announcement.

Chris Willis:

And then all of a sudden recently, you had a same day press release from both Google and from HUD basically saying the two parties had talked to each other and seemingly worked something out, that Google was removing certain attributes from ad targeting models that were applicable to credit employment and housing advertisements. So it had made those changes, in essence. And so what I think that reminds us about is that even though it's not a coronavirus-related issue, the regulators are still very attentive to the issue of targeted advertising for financial services products and housing, as it relates to HUD, and that the action in that area has not died down, it is continuing, and that financial institutions still need to be very aware of the potential risks there.

Chris Willis:

Another thing that happened earlier this year was the publication of an article on this subject by two people from the Federal Reserve in the Federal Reserve's Consumer Compliance Outlook warning about the dangers of targeting of financial services advertisements under the fair lending laws. So it's something that we definitely should not lose sight of when we're distracted by everything that's going on with COVID-19.

Alan Kaplinsky:

Yeah. Let's turn now to the CFPB again, seems like still a favorite topic of ours. Very recently, they came out with some guidance regarding advisory opinions. And this is a new program that they want to get involved in, that the industry is very much supportive of, but it seems like consumer advocates are very skeptical about it and think that it'll be used as a tool by the industry to create safe harbors and insulate them from liability. Tell us a little bit about that program, Chris.

Chris Willis:

Yeah, sure. And what's interesting is the industry and consumer views on that mirror, what we saw with the CFPB innovation proposals some months ago, the no action letter program and the pilot disclosures program, et cetera. And so here, what we have is we have an advisory opinion program, where the bureau is basically signaling its willingness in response from requests from industry participants, issue advisory opinions that would be interpretive guidance about the various statutes that it's responsible for enforcing. And it's laid down some general guidelines about how to do it and when they will probably do it and when they probably won't, like UDAAP, for example, being one where they probably won't do it, applying a general prohibition like UDAAP to some specific facts.

Chris Willis:

But it is something that could be very helpful when you have a provision of a statute or a regulation that just isn't clear, and you're not sure which way to go with it. It gives the CFPB a way to give an answer to that question in a way that's communicated to the entire industry and the public at once and that would help in terms of driving compliance in the correct direction without leaving people guessing. And so that's why, obviously, industry likes it because it provides the potential for greater certainty. The consumer groups, as you mentioned, are in opposition to it because they feel like it will be used to create exceptions or loopholes or lessen the protection for consumers that the statutes or regulations themselves would provide.

Chris Willis:

Query, how would consumer groups feel about it if it were the Richard Cordray CFPB that we're giving the advisory opinions? No, there probably wouldn't be quite as strong of an opposition, I don't think. So I think that opposition is situational rather than structural in terms of having an advisory opinion program. It really remains to be seen how much the bureau will actually use the advisory opinion program. I hope it uses it. I think it's nothing but a positive to provide greater guidance to the industry because there are tons and tons of situations where it's just not clear how to interpret one of the laws or regulations. And this could help in a way that's much faster and easier to deal with than doing a rulemaking under the Administrative Procedure Act. So I'm hopeful about the advisory opinion program and I hope it is well used.

Alan Kaplinsky:

Yeah. Yeah, I agree with you. When the Federal Reserve was in charge of administering a lot of the federal consumer financial laws that are now being administered by the CFPB, they used an official staff commentary that they would regularly update. I don't remember now whether it was every six months or once a year. But if there were issues that would crop up, they would accumulate them and then they would propose them as part of changes to the official staff commentary and then they would finalize them. And courts were required to defer to that.

Chris Willis:

That's right.

Alan Kaplinsky:

CFPB hasn't done that. They still have an official staff commentary, but it's hardly ever used. It's not used in the way that these advisory opinions would be. So I think this would be much more useful, frankly, and a terrific addition to helping everybody, not just the industry figure out what the answers are to some of the naughtier questions that people struggle with every day.

Chris Willis:

Yeah. And what's interesting, Alan, is that that old Fed commentary, the CFPB adopted all of it. It's still there. And it's still, honestly, one of the first places that we look to as practitioners to find the answers to questions that clients asks us or that come up in various cases. But you're right, the CFPB has not updated it. It just adopted what the Fed did and then left it since they took over those regulations for the most part. Interestingly though, with the proposed debt collection rulemaking, there is actually an official staff commentary that goes along with it that they would propose to adopt with the rule that is structured identically to the official commentary on Reg Z, for example. So it would be nice if the bureau did what the Fed did and updated that more regularly. It would be sorely needed with that debt collection rulemaking, I assure you. But we'll see.

Alan Kaplinsky:

Hey, you mentioned the debt collection rulemaking, when do you think that's going to be finalized?

Chris Willis:

Well, I had been predicting that it would be around September of this year. Originally, the CFPB had been saying that it was going to come out in April or May of 2020. But I didn't think that was likely to happen because it's a very large rulemaking with a lot of naughty issues and lots of comments, and I didn't think the bureau would be able to do it by April or May of this year, and of course, that didn't happen. But the bureau now released its semi-annual rulemaking agenda and stated that they expect to release the final debt collection rule in October of 2020.

Chris Willis:

So the bureau is now being very specific about when it thinks that rulemaking will be completed. It's similar to the prediction I was making beforehand. I was thinking it was going to be September, they're saying October. So we'll hope that it comes out in October with an effective date. It had been proposed to be effective a year after the final rule is promulgated. So we would think the effective date would be October of 2021. But we'll, of course, have to wait and see if that holds true later this year.

Alan Kaplinsky:

Yeah, okay. Final topic for today, Chris, and a very important topic, I think. And that it relates to a... It all goes back to a Second Circuit opinion in the Madden case, Madden versus Midland Funding, Midland Funding being a debt buyer. In the Madden case, Bank of America sold charged-off credit card receivables to Midland Funding. And Midland Funding continue to charge on the receivables the interest rate that the Bank of America was permitted to charge under federal law, namely Section 85 of the National Bank Act, and the Law of Delaware, where B of A's bank was located, which essentially deregulated interest rates completely. So, few years ago, Second Circuit really threw a bombshell to half the industry by concluding that the

debt buyer once it blocked the receivables, it could not charge an interest rate any higher than the general usury law in the State of New York.

Alan Kaplinsky:

The Midland Funding filed the cert petition with the US Supreme Court. The solicitor general, through the Comptroller of the Currency, urged the court not to grant cert, but did a very strange thing in the opinion or in the brief. It said it disagreed with the Second Circuit opinion and Madden, that thought it was wrong, that it was contrary to the so-called valid when made doctrine, namely that a loan that's not usurious, that inception doesn't become usurious because of some event that occurs after the longest originated. But it urged the court not to grant cert apparently because at the time there was no conflict. I then wrote an op-ed in the American Banker, where I urged the OCC to write a regulation under Section 85. I urged the FDIC to follow suit, to write a regulation under Section 27A of the Federal Deposit Insurance Act, which confers on state charter banks the same usury authority Section 85 confers on national banks, namely the right to export the interest rate permitted under its home state law throughout the country.

Alan Kaplinsky:

I was at a conference and then the Comptroller of the Currency, Tom Curry, was speaking at the conference and he talked about the Madden case. And I got up and I said, "Mr. Curry, you have a way of resolving this problem." And I harken back to what the OCC and the FDIC had done a couple of decades ago, when there was all the litigation around the country as to whether late fees constituted interests within the meaning of Section 85 of the National Bank Act. And that didn't get resolved until essentially the 11th hour when there was a case pending before the US Supreme Court called Smiley versus Citibank, and the OCC and then the FDIC finalized regulations basically saying that interest under Section 85 and Section 27A included essentially all components of the pricing package of a loan, and including, for purposes of the Smiley case, a flat late fee.

Alan Kaplinsky:

At that point, Comptroller of the Currency, Curry, scoffed at my idea saying, "Oh, we can't get involved in the middle of litigation. We have to let these issues percolate. We can't deal with it." Well, of course, he was flat out wrong because that's exactly what the OCC had done a long time ago on the Smiley case. They jumped right into that litigation. They wanted to nip it in the bud and they did resolve the issue. Well, anyway, tell us now what the OCC and the FDIC are doing to try to resolve this Madden decision.

Chris Willis:

Sure. Well, both of them in May and June of this year respectively issued rules that basically undid the Madden case and said that when a national bank or a state chartered FDIC insured bank, using its interest rate exportation authority under the National Bank Act or the Federal Deposit Insurance Act, makes an extension of credit, that extension of credit is valid in terms of its interest rate and is preempted with respect to state usury statutes, even if the obligation is later sold or assigned to some non-bank third party. So it basically takes the valid when made doctrine that you alluded to a moment ago and makes it the official law per the regulations of both the OCC and the FDIC, which has the effect of undoing the Madden decision and saying that transfer of a credit obligation by national bank or FDIC state charted insured bank won't have any effect on the permissible interest rate. It stays the same as if it were still the bank that held the obligation.

Alan Kaplinsky:

Yeah. You think the courts will end up deferring to the FDIC and the comptroller?

Chris Willis:

I would think so because it is an area that concerns a law that they interpret and apply, Section 85 and Section 27 of the Federal Deposit Insurance Act. And it was done after a notice and comment rulemaking process. So you would think that there would be deference to it, unless a court were able to find that the agency's interpretation was squarely in conflict with the

statutes, and the language of the respective statutes, Section 85 of the National Bank Act and Section 27 of the Federal Deposit Insurance Act doesn't specifically speak to transfers of loans. It just says the bank can do this essentially when it originates a loan. And so it's likely to me to be within the range of reasonable interpretation of the statute. So I do think there will be difference to these regulations.

Alan Kaplinsky:

And of course, the Supreme Court in the Smiley case deferred to the OCC regulation, one that got finalized literally while the case was pending before the US Supreme Court.

Chris Willis:

That's right.

Alan Kaplinsky:

So I think that augurs well. I think it should be noted that this case and the Madden case and the regulations that you're talking about, Chris, have implications that go well beyond the sale of charged-off credit card receivables. It could apply to securitizations of credit card receivables. There is litigation pending that actually challenges the ability of credit card securitization trusts to continue to charge the same interest rate that the bank that originated the credit card is allowed to charge. It also has very important implications in the area of marketplace lending, the use of the so-called bank model, where banks will partner with fintech companies and originate all kinds of loans and then sell the loans either to the fintech company, or they could sell them to some unaffiliated third party. Private label credit cards is another area where it's important. However, the one thing that it does not cover and the OCC and the FDIC have made it very clear, it does not cover the true lender issue.

Chris Willis:

Yeah, correct.

Alan Kaplinsky:

And I wonder if you could briefly describe what that is, Chris, and how that differs from the Madden issue?

Chris Willis:

Yeah, sure. The true lender issue is a creature of state law that represents a legal theory that has been pursued mostly by state attorneys general and other state financial services regulators when there is a situation where you have a bank and a non-bank working together to originate and then service a credit product. And the true lender doctrine asserts that if the non-bank is too heavily involved in both the origination and servicing of the product and the setting of the terms and conditions and parameters of the product, and it's too much involved in the economics of the product, experiencing the profit from interest, bearing credit risk on the portfolio, et cetera, then the state court is free to deem the non-bank to be the true lender, even though the loan is made in the name of the bank and on a promissory note or other credit obligation that's made payable to the bank.

Chris Willis:

It's the idea that, "Well, that's just form and we're going to look to the substance underlying the transaction, and the substance of what we have is we have a non-bank that's trying to get a free pass on our usury statutes by associating itself with a bank." But really, it's the non-banks loan program. And so we're going to deem the non-bank as the true lender, apply our usury statute to the transaction and ignore the otherwise preemptive effect of the bank's presence as the nominal lender in the transaction. That's basically what the doctrine is.

Alan Kaplinsky:

There is some hope that the OCC and the FDIC are going to deal with that by regulation too, in that the new acting Comptroller of the Currency, Brian Brooks, indicated in a speech very recently that he has put on his agenda the need for there to be greater certainty on the true lender issue. And that he suggested there would be a proposed rulemaking between the FDIC and the comptroller dealing with the issue. My only concern is I wish that acting comptroller, Brooks, had been appointed a few years ago because I really worry about whether there's going to be enough time to accomplish that, to propose it and finalize it and get it all done prior to January 20th.

Chris Willis:

Yeah. I share your view that that is difficult to do within that timeframe, but also share your view that it's sorely needed, because the true lender doctrine is very imprecise, and nobody knows exactly where a particular state regulator or state court will draw the line between acting as a service provider to assist a bank in originating a credit transaction and becoming the true lender, and therefore subject to usury laws. That uncertainty suppresses the availability of credit products to the marketplace, which demands them clearly because they are very popular products, the marketplace loans, for example. And so that uncertainty does no one any good, neither consumers nor the industry, and a rule would really help to establish the boundary, and then industry can conform its conduct to whatever the regulators say is the appropriate thing to do. But I do worry that there's not enough time between now and January to actually see as controversial a rulemaking like that through to completion when it hasn't even... They haven't even proposed a rule yet.

Alan Kaplinsky:

Okay. Chris, thank you very much for joining me on the program today. Also, want to thank everybody who has downloaded this podcast. Our podcasts are available on our website, and they're also available on Apple Podcasts, Google Play, Spotify, or whatever your favorite podcast platform may be. And don't forget to check out our blog also called Consumer Finance Monitor for all the latest developments in the consumer finance industry. We really try to cover the waterfront to keep you abreast of the developments that are happening. And between our webinars, our blogs, and our podcasts, we really are, I guess you could say, a place to do one-stop shopping, where you can fulfill all the needs that you have to stay abreast of developments in our consumer finance industry.

Chris Willis:

And you can do it well social distancing too.

Alan Kaplinsky:

Yes, absolutely. Well, and the good thing is we don't have to wear masks also, Chris. We release our podcasts generally every Thursday, except on certain holidays. It's a weekly show. If you have ideas for other podcasts or you have any comments on our show, please feel free to email Chris or me, or you can send an email to podcast@ballardspahr.com. And stay tuned each Thursday for a new episode of our show. Thank you again for listening.