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OCC *Madden* rule is first step toward needed clarity for banks, fintechs, and nonbank lenders

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JUNE 22, 2020

The Office of the Comptroller of the Currency (OCC) issued a final rule[1] on May 29 clarifying that when a national bank or national savings association sells, assigns, or otherwise transfers a loan, interest permissible before the transfer (the maximum rate permitted in the bank's home state) continues to be permissible after the transfer.

This marks one of the first acts of Acting Comptroller of the Currency Brian P. Brooks, who assumed office that same day.

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The final rule follows the OCC's proposed rule on this topic, and will take effect 60 days after the June 2 publication in the *Federal Register*, or on August 3. The Federal Deposit Insurance Corporation (FDIC) issued a similar proposed rule on this topic in November 2019, but it has not yet issued a final rule.

The OCC states that it received more than 60 comments on its proposed rule, including comments from industry trade associations, nonbank lenders, community groups, academics, state government representatives, and members of the public.

While, according to the OCC, many commenters were supportive of the proposed rule (and pointed to the legal uncertainty discussed in the proposal that has had negative effects on the primary and secondary markets for bank loans), many commenters also opposed the proposed rule.

Those opposing the proposed rule raised both legal and policy concerns in their comments (including as to whether the OCC has the authority to issue this regulation and whether the proposed rule complied with the Administrative Procedures Act).

The new OCC rule effectively adopts a pair of common law doctrines: "valid when made" and "most favored lender." The former states that a loan that is not usurious at inception cannot subsequently become usurious by reason of its sale.

Relatedly, the "most favored lender" doctrine permits a national bank or federal thrift, having operations in more than one state, to select the law of its home state to govern the interest rate on all of its loans, including those to borrowers in states with more restrictive usury laws.

These two doctrines work in tandem to allow banks to originate and then assign loans to nonbank partners, with the loan continuing to benefit post-assignment from the preemptive effect of the bank's status as a federal bank or savings association.

Were the loan not to maintain such status, in many cases state law would prohibit a nonbank from collecting interest at a rate above that permissible in the borrower's state.

MADDEN V. MIDLAND FUNDING

As we have previously discussed (see our posts from May 2016,[2] June 2016,[3] and March 2017[4]), a 2015 decision from the US Court of Appeals for the Second Circuit, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), called into question the validity of this preemptive effect on interest rates following a bank's assignment of a loan to a nonbank entity.

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Although the court did not directly address the "valid when made" doctrine, many viewed the decision as an assault on that doctrine, stating that *Madden* undercut settled expectations that interest rates, valid at origination, would continue to be enforceable following a bank's sale of the loan to a nonbank.

In *Madden*, the New York resident plaintiff asserted that New York's usury limitations applied to a credit card debt incurred with a national bank located in Delaware that was sold post-default to a third-party debt collector.

Delaware does not impose interest rate limitations on such debts, so the interest rate charged by the national bank was not restricted by any state's laws.

The national bank had sold the plaintiff's defaulted credit card debt to Midland Funding, which is not a bank and which sought to collect the debt at the contractual default interest rate of 27%, a rate higher than permitted in New York.

The OCC's final rule release observes that the National Bank Act (NBA) is "conspicuous[ly]" silent with respect to loan transfers and the agency's opinion is that "it is appropriate to resolve the silence."

The final rule cites to three main propositions as calling for the necessary clarification. First, the OCC rule notes that, notwithstanding the Second Circuit's 2015 *Madden* decision, the weight of the case law (including US Supreme Court precedent) supports the concept that the usurious or non-usurious character of a contract endures even after assignment.

> While the rule does not resolve all legal uncertainty for every loan transfer, it may offer some leverage in private litigation and in conversations with state banking and consumer protection regulators.

Second, according to the final rule, national banks' authority under the NBA to assign contracts requires this clarification because an assignment would be ineffective were the pre-assignment interest terms to be deemed unenforceable following the transfer.

Third, and relatedly, the OCC remarked that its interpretation was necessary because the ability to transfer loans is an important tool used by banks to "manage liquidity and enhance safety and soundness."

IMPORTANCE TO FINTECHS AND NONBANK LENDERS

The OCC's rule should bring some additional certainty to the secondary loan market, especially in the commercially important Second Circuit, to the extent that OCC-regulated banks are participants in that market.

That said, for several reasons discussed below, the OCC's final rule does not trumpet an "all clear" message for fintechs and nonbank lenders that operate under a bank partnership model. Rather, those parties must remain vigilant at the structuring stage of loan purchase transactions.

First, the OCC rule applies only to national banks and national savings associations. Partnerships with state-chartered banks will not be affected until (and if) the FDIC issues its analogous final rule and, at this time, it is not clear why the FDIC has not taken corresponding action on its proposal.

Second, the level of deference that courts afford to this agency rulemaking remains to be seen and involves difficult questions of constitutional and administrative law.

Accordingly, whether the OCC's final rule "overrules" the continued applicability of the *Madden* decision is an open point that may later be considered by the courts.

The focus in *Madden* was on whether federal interest rate preemption extended to the nonbank assignee. Based on the OCC's final rule, however, a court may sidestep the question of extending preemption and rely solely on the rule.

Third, neither the OCC's final rule nor the FDIC's proposed rule in any way addresses the separate "true lender" questions that have been raised in litigation.

While some commenters requested that the OCC establish a test for determining when the bank is the true lender, the OCC states that this "would raise issues distinct from, and outside the scope of, this narrowly tailored rulemaking."

Further, both the OCC's final rule and the FDIC's proposed rule take aim at so-called "predatory lending," including through bank partnership programs. The FDIC's proposed rule expressly cautions that the agency "views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state."

With the above caveats in mind, the OCC's final rule has the potential to provide an additional arrow in the quiver for fintechs and others that purchase bank-made loans.

While the rule does not resolve all legal uncertainty for every loan transfer, it may offer some leverage in private litigation and in conversations with state banking and consumer protection regulators.

In conclusion, fintechs and nonbank lenders operating under a bank partnership model should continue to exercise diligence as they structure their programs rather than interpret the OCC's new rule as ushering in an era of lax regulatory scrutiny or foreclosing usury arguments by private litigants.

Lastly, nonbank lenders should stay abreast of related state law requirements, including loan brokering and debt collector licensing requirements.

Notes

[1] https://bit.ly/3d8dKCf

[2] https://bit.ly/3d8tPrS

[3] https://bit.ly/37CnIuE

[4] https://bit.ly/3fy4gSr

This article appeared on the Westlaw Practitioner Insights Commentaries web page on June 22, 2020.

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