Special Alert: OCC and FDIC propose rules to override *Madden*

November 22, 2019

On November 18, 2019 the Office of the Comptroller of the Currency ("OCC") issued a proposed rule to clarify that when a national bank or savings association sells, assigns, or otherwise transfers a loan, the interest permissible prior to the transfer continues to be permissible following the transfer.[1] The very next day, the Federal Deposit Insurance Corporation ("FDIC") followed suit with respect to state chartered banks.[2] The proposals are intended to address problems created by the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*[3], a decision that cast doubt, at least in the Second Circuit states, about the effect of a transfer or assignment on a bank loan's stated interest rate that was nonusurious when made. Comments on these proposals are due 60 days following publication in the *Federal Register*, and as noted below, the case for robust banking industry comment is more compelling than is typically the case.

The Madden Decision

We have had several occasions to critique the *Madden* decision[4], which erroneously held that state usury laws may prohibit a national bank's assignee from enforcing the interest rate on a credit agreement that was valid under the law of the state in which the national bank is located. The holding conflicts with the valid-when-made doctrine, long recognized in common law, as well as with key preemption principles stemming from a national bank's Section 85 authority to charge interest up to the maximum permitted by

[1] Permissible Interest on Loans That are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64229, (proposed Nov. 18, 2019), available at https://www.occ.gov/news-issuances/news-releases/2019/nr-occ-2019-132a.pdf.

[2] FDIC Notice of Proposed Rulemaking, Federal Interest Rate Authority, FDIC (proposed Nov. 19), available at https://www.fdic.gov/news/board/2019/2019-11-19-notice-dis-c-fr.pdf.

[3] *Madden v. Midland Funding, LLC,* 786 F.3d 246 (2d Cir. 2015), *cert. denied,* – U.S. – 136 S. Ct. 2505 (2016).

[4] Walter E. Zalenski, Jeffrey P. Naimon, & John P. Kromer, *Special Alert: Second Circuit Will Not Rehear Madden Decision That Threatens to Upset Secondary Credit Markets*, Buckley LLP, Aug. 14 2015, available at https://buckleyfirm.com/uploads/1082/doc/Madden_Special_Alert_Final_8_13_15_pdf.pdf; Walter E. Zalenski, Jeffrey P. Naimon, & John P. Kromer, *Special Alert: Second Circuit Decision Threatens to Upset Secondary Credit Markets,* Buckley LLP, June 12, 2015, available at https://buckleyfirm.com/uploads/1082/doc/Special-Alert-re-Madden-v-Midland_Funding_LLC.pdf.

its home state[5] and from the power in Section 24(Seventh) of the National Bank Act[6] to sell loans that it originates.

Despite *Madden's* manifest problems, the Supreme Court declined to hear the case. The holding survived further proceedings on remand from the Second Circuit and the case subsequently settled. Efforts to obtain a "legislative fix" in Congress have not been successful. Now four years on, at least two national banks face class action lawsuits alleging that typical bank securitization structures are inconsistent with *Madden* and effectively violate state usury law[7] and one state has brought actions that rely in part on *Madden* to challenge the enforceability of loans made by banks in connection with fintech partnerships.[8]

The OCC Proposal

The OCC proposal, at bottom, simply adds one sentence addressing loan transfers to the agency's preemption regulations stating, "[i]nterest on a loan that is permissible under 12 U.S.C. 85 shall not be affected by the sale, assignment, or other transfer of the loan."[9] The background information the agency provided with the proposal supports this clarification by reference to the well-established valid-when-made doctrine, fundamental principles of contract assignment, the express powers set forth in the National Bank Act, and the Section 85 interest rate "exportation" doctrine.[10]

The OCC is very clear on one issue that it considers outside the scope of the proposal: "This rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party. The true lender issue, which has been considered by courts recently, is outside the scope of this rulemaking."[11] While *Madden* and true lender issues are sometimes conflated, they are properly viewed as distinct, and it is plain that the OCC seeks to maintain that distinction for purposes of the rulemaking.

As with all issues of bank preemption of state law, complexities abound, not all of which are expressed in the background material issued by the OCC. For example, the Second Circuit treated *Madden* as a preemption case under the *Barnett* preemption standard articulated by the Supreme Court in 1996[12] and

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[5] 12 U.S.C. § 85.

[6] 12 U.S.C. § 24(Seventh).

[7] *See Cohen v. Capital One Funding LLC*, No. 19-cv-03479 (E.D.N.Y. filed June 12, 2019); *Cohen v. Chase Card Funding, LLC,* No. 19-cv-00741 (W.D.N.Y. filed June 6, 2019); Walter E. Zalenski, *NY Credit Securitization Class Action Misuses Madden*, Law360, July 18, 2019, available at https://www.law360.com/articles/1178023/ny-credit-card-securitization-class-action-misuses-madden.

[8] *See Meade v. Avant of Colorado LLC,* No. 17-cv-620 (D. Colo. filed Mar. 9, 2017); *Meade v. Marlette Funding,* No. 17-cv-575 (D. Colo. filed Mar. 3, 2017).

[9] 84 Fed. Reg. 64229, 64232 (Nov. 21, 2019).

[10] 12 U.S.C. § 85.

[11] 84 Fed. Reg. 64229, 64232 (Nov. 21, 2019).

[12] *Barnett Bank of Marion County, N. A. v. Nelson*, 517 U.S. 25 (1996).

codified in Section 1044 of the Dodd-Frank Act ("DFA"). The court found that the application of New York usury law to the debt purchasers did not "significantly interfere with"[13] the ability of the originating national bank to exercise its powers. The OCC in its rulemaking response to *Madden* does not address or apply **–** or even mention **–** the *Barnett* DFA preemption test.

The DFA also imposed limitations on the OCC's ability to preempt certain types of state law, including limiting the scope of preemption rulings by requiring that the OCC make them on a "case-by-case basis" focusing on a particular state law.[14] That said, in a provision that likely will prove pivotal to the OCC's efforts, DFA Section 1044(a) makes clear that the new preemption procedural requirements imposed on the OCC in the DFA do not apply to Section 85 interest rate exportation.[15]

The FDIC Proposal

Fundamentally, the FDIC proposal addresses *Madden* in the same way, although it does so based on the separate legal authority applicable to state banks, including the rate exportation authority reflected in Section 27 of the Federal Deposit Insurance Act. The proposal states that, "[w]hether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made… [and] shall not be affected by any subsequent events, including a change in State law, a change in the relevant commercial paper rate after the loan was made, or the sale, assignment, or other transfer of the loan."[16]

The FDIC also mirrors the OCC in specifying that the proposal does "not address the question of whether a State bank … is a real party in interest with respect to a loan or has an economic interest in the loan under state law, *e.g.* which entity is the 'true lender.'"[17] Nevertheless, the *Madden* versus true lender distinction was central to a dissent made by FDIC Board Member Martin J. Gruenberg. Gruenberg acknowledged that "[m]ost banks enter into third party arrangements with considerable care and oversee them to ensure consistency with applicable law and bank policy, including appropriate safety and soundness principles and effective consumer compliance programs," but he nevertheless found that the proposal "may effectively undermine an evaluation as to whether the bank is the actual or true lender of the loan and not a vehicle for a nonbank third party to benefit from state preemption through a rent-a-charter

[13] *Id.* at 33-34.

[14] DFA § 1044(a), 124 Stat. at 2015.

[15] 12 U.S.C. 25b(f).

[16] FDIC Notice of Proposed Rulemaking, Federal Interest Rate Authority, (proposed Nov. 19) at 40-42, available at https://www.fdic.gov/news/board/2019/2019-11-19-notice-dis-c-fr.pdf.

[17] *Id.* at 11.

arrangement."[18] In a sentiment that is likely to be echoed by consumer advocates, Gruenberg advocates "a careful weighing of the federal and state interests … in particular cases, not a blunt rulemaking…."[19]

Industry Comments

As noted initially, the case for industry support in the public comment period seems particularly urgent. Other avenues to correct *Madden* have been unavailing in providing certainty to secondary credit markets. The proposals in part implicate complex issues of federal preemption. The OCC rule, if adopted and subsequently challenged, potentially could be subject to the less deferential *Skidmore* standard provided in the DFA[20] as opposed to a more deferential review under the *Chevron* test. Finally, as reflected in FDIC Member Gruenberg's statement when voting against the proposed rule, these initiatives in effect may also become a proxy war for broader true lender issues.

If you have any questions about the alert or other related issues, please visit our Fintech practice page or contact a Buckley attorney with whom you have worked in the past.

[18] Martin J. Gruenberg, FDIC Board of Directors, "Notice of Proposed Rulemaking on Federal Interest Rate Authority," (Nov. 19, 2019), available at https://www.fdic.gov/news/news/speeches/spnov1919d.pdf.

[19] *Id.*

[20] *Compare* 12 U.S.C. § 25b(b)(5)(A) ("A court reviewing any determinations made by the Comptroller regarding preemption of a State law by title 62 of the Revised Statutes or section 371 of this title shall assess the validity of such determinations, depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision") with *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) ("The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.").