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OCC and FDIC Issue Final Rules on "Valid When Made"

Marc P. Franson*

In this article, the author explains a final rule recently issued by the Office of the Comptroller of the Currency, which codifies as a regulation that the interest charged on loans that is permissible before a loan is transferred remains in effect after the loan is transferred.

The Office of the Comptroller of the Currency ("OCC") recently issued its final rule codifying as a regulation that the interest charged on loans that is permissible before the loan is transferred remains in effect after the loan is transferred. The one sentence regulation: "Interest on a loan that is permissible under 12 USC 85 shall not be affected by the sale, assignment or other transfer of the loan" will be codified for national banks at 12 CFR 7.4001(e) and a similar regulation for federal savings associations at 12 CFR 160.10(a). These codifications became effective August 3, 2020.

THE FINAL RULE

Though this regulation is intended to clarify the agency's position relative to the U.S. Court of Appeals for the Second Circuit decision of *Madden v. Midland Funding, LLC*,[1] the promulgation also states that this rulemaking does not address which entity is the true lender of a loan. The Federal Deposit Insurance Corporation ("FDIC") issued a similar rule that would apply to state chartered banks that became effective August 21, 2020. The OCC has indicated that its rule is intended to function in the same way as the FDIC proposed rule.

While this OCC regulation (and the FDIC regulation) will not prohibit litigants from alleging *Madden* types of claims, the regulations should provide a potent defense to such claims and at minimum would knock out claims that a non-bank assignee is not entitled to enforce the interest rate terms of a loan made by a federally insured depository institution. Under the *Chevron* doctrine courts must consider giving deference to the interpretations of federal agencies with jurisdiction over certain entities or subject matter. Under this principle, courts should give weight to the opinions of the banking regulators and find

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[1] 786 F.3d 246, cert. denied, 136 S.Ct.2505 (2016).

that interest made at loan inception carries through to assignees. However, courts are not required to agree with agencies, and it is anticipated that litigants will challenge these rules. It is also possible, particularly if the fall elections change the political landscape, that the rules could be negated by an act of Congress under the Congressional Review Act. In fact, the attorneys general of three states (California, Illinois, and New York) have filed suit against the OCC challenging the rule.[2] The FDIC rule was not challenged in that proceeding.

One court case has already found that it must follow the OCC valid when made regulation and find that the bank's rates apply to a non-bank assignee, even though it appeared that the judge was inclined to rule otherwise had the rule not been in effect.[3] In that case the judge remanded the action for consideration of the true lender issues that might exist. The OCC has proposed a rule clarifying the true lender issue also which merely states that the true lender is the entity whose name is on the loan documents as the lender or who funds the loan. Public comment on that proposed rule ended September 3, 2020. The FDIC has not issued a similar rule.

The OCC stated in its Final Rule that banks are entitled to charge interest at rates allowed in the state(s) where it is located and also have authority to assign loans. The OCC stated that its regulation is designed to encourage responsible lending and provide better access to credit citing studies indicating that access to credit declined after the *Madden* decision in the three states located in the Second Circuit.

The OCC spent a large portion of its analysis of the regulation on rejecting claims made by public comments in opposition to the proposed rule, most importantly, that the OCC did not have the authority to issue the regulation. Under existing law, a statute must be ambiguous in order for the agency to issue a regulation. In this case, the statute was silent concerning interest terms when loan terms are assigned. Opponents said this was not an ambiguity, but the OCC stated that due to uncertainty presumably caused by the *Madden* decision, express interpretation was necessary to resolve the silence of the statute.

The OCC made several persuasive arguments in this regard. The first is that under federal law national banks have the right to enter into contracts and

[2] *People of the State of California, et al. v. The Office of the Comptroller of the Currency, et al.*, Complaint for Declaratory and Injunctive Relief, Case No. 4:20-cv-05200 (N.D. Cal. Filed 7/29/2020).

[3] *See, Rent-Rite Superkegs West LTD v. World Business Lender, LLC*, Case No. 1:19-cv-01552-RBJ (D. Colo. 8/12/2020).

assign contracts and the character and terms of a contract endures its assignment. In other words, interest terms should not be treated differently based upon the status of an assignee, rather the assignee steps into the shoes of the assignor. As the OCC stated, a contract should not be usurious depending on who is enforcing it, rather who made it. Significantly, assignment should not alter a borrower's original obligation to repay the original terms that were agreed upon. While there is significant precedent on these points, the OCC was careful to state that these common law tenets served to inform the OCC's decision, but were not the sole basis of that decision. The OCC gave short shrift to opponents who claimed the *Madden* decision foreclosed their rulemaking by stating that *Madden* neither considered or decided the scope of Section 85 as to a national bank. It also disagreed with commenters who claimed the agency had exceeded its authority and did not follow the Administrative Procedures Act.

The OCC also made it clear that this regulation is not one dealing with preemption of state law, rather it is narrowly construing a statute that is rooted in and relies on state law. Some opponents contended that this rule will facilitate predatory lending. The OCC again disagreed and addressed the issue by stating that appropriate third party relationships play an important role in the operations of banks and the economy and are better addressed in already issued OCC guidance on third party relationships rather than a regulation dealing with interest rates.

The OCC strongly endorses the rule as needed not only for clarifying what happens to interest rates on loans when they are sold, transferred or assigned as being consistent with the underlying statute which allows for nationwide uniformity in lending and promotes safety and soundness precepts for liquidity management which were undermined by *Madden*. It would be illogical to apply the statute to loans only held to maturity by a bank, as banks need to sell loans for liquidity purposes and to have uncertainty on the terms of the loans negatively affects both the primary and secondary markets for loan sales.

CONCLUSION

For banks selling loans, this regulation provides both the clarity and certainty that the OCC is seeking in making this rule. If challenged by *Madden* type theories, the federal regulations will assist banks and credit markets in feeling comfortable that loans made upon terms at the loan's inception should carry through until payment or maturity, no matter whom the holder of the loan is. Hopefully, litigation based on *Madden* theories will be deterred or dismissed. The OCC ruling and the FDIC rule are consistent with precedent dealing with contractual rules of assignment and will promote less volatility in the secondary markets dealing with loan sales. It is also significant that this was one of the first official acts of the new acting Comptroller of the Currency, Brian Brooks.

However, the existing and potential court challenges and potential rollback that could occur legislatively do not make this a "done deal."