Client Alert | Financial Institutions Advisory

OCC Finalizes *Madden*-fix Rule; New Acting Comptroller Lays Out Priorities

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In an effort to resolve the legal uncertainty created by the US Second Circuit Court of Appeal's 2015 decision in *Madden v. Midland Funding, LLC*, the OCC has issued a final rule to clarify that when a national bank or savings association sells, assigns or otherwise transfers a loan, the interest permissible before the transfer continues to be permissible after the transfer. This final rule constitutes the first major policy action under new Acting Comptroller of the Currency, Brian Brooks, who has outlined fintech, innovation, and fair access priorities for the agency. The final rule, however, does not appear to settle conclusively the uncertainty that the *Madden* decision created.

OCC Finalizes *Madden*-fix Rule

On May 29, 2020, the Office of the Comptroller of the Currency ("OCC") released its final interpretation of the scope of Section 85 of National Bank Act and Section 4(g) of the Home Owners' Loan Act with respect to permissible interest rate exportation by national banks, savings associations, and (by extension) uninsured federal branches of non-US banks ("banks"), respectively.

The final rule adopts as proposed the OCC's November 2019 proposed rule intended to address the uncertainty created by the *Madden* decision, which called into question longstanding "valid-when-made" and "stand-in-the-shoes" principles relied upon by loan originators, securitizers and investors. According to Acting Comptroller Brooks, the final rule:

> *. . . supports the orderly function of markets and promotes the availability of credit by answering the legal uncertainty created by the 'Madden' decision. Such certainty allows secondary markets to work efficiently and to serve their essential role in the business of banking and helping banks access liquidity and alternative funding, improve financial performance ratios, and meet customer needs.*

The final rule seeks to address confusion that the *Madden* decision caused concerning a loan's permissible interest rate when a bank originates the loan and then assigns it to a third-party non-bank entity (please see our prior **alert** for additional background on the *Madden* decision). Federal law permits banks to charge interest at the maximum rate permitted to any state-chartered or licensed lending institution in the state where the bank is located, regardless of the location of the borrower. Federal law also explicitly authorizes banks to enter into contracts and, inherent to that power, assign those contracts. A bank's ability to both originate and assign loans underpins US loan and securitization markets.

While federal law does not explicitly address whether transferring a loan affects that loan's interest rate, the OCC reaffirms in the final rule its longstanding view that "when a bank transfers a loan, interest permissible before the transfer continues to be permissible after the transfer." Interest permissible on a loan when originated by a bank is therefore not impacted by the bank's sale, assignment or other transfer of the loan. In other words, the interest permissible for the bank to charge prior to the sale, assignment or other transfer

will continue to be permissible following such transfer, regardless of whether the assignee would be permitted to charge such interest if it were the originator of the loan.

Certain commenters raised objections to the OCC's proposed rule, arguing that the OCC is foreclosed from adopting the rule by the *Madden* decision under federal law; that valid-when-made is not a historical usury principle that supports the OCC's proposal; that there is no basis to conclude that federal law should preempt state usury laws based on a bank's power to assign contracts; and that there is no basis to conclude that federal law should preempt state usury laws based on a bank's authority to transfer loans. The OCC rejected these comments, concluding that it has the authority to issue the final rule in order to interpret a statutory ambiguity and that its rulemaking process met all requirements under the Administrative Procedures Act ("APA").

While the final rule is a step towards restoring certainty for industry participants, including banks, investors and nonbank partners, it fails to resolve completely the ambiguity that the *Madden* decision created. The rule does not directly overturn *Madden* and, as a result, its significance may ultimately turn on how much deference courts are willing to give to agency interpretation of federal law under the *Chevron* doctrine. In addition to potential challenges to its substantive legal interpretations, the final rule may also be subject to procedural challenges under the APA. Further, the Federal Deposit Insurance Corporation has not yet finalized its companion rule proposed in November 2019 that would apply to state-chartered banks and insured branches of foreign banks, although it is expected to do so soon.

Key takeaways	
What the final rule does	▪ Codifies the OCC's long-held interpretation of federal law that non-usurious loans originated and then transferred from a bank to a non-bank entity cannot subsequently be deemed usurious under state usury restrictions. ▪ Makes this clarification for national banks, savings associations, and (by extension) uninsured federal branches of non-US banks.
What the final rule does *not* do	▪ Make a similar clarification for state-chartered banks or insured branches of foreign banks. ▪ Overturn the Second Circuit's *Madden* decision. ▪ Constitute legislative action to invalidate *Madden* or otherwise amend the National Bank Act, which *Madden* and the final rule interpret. ▪ Address the "true lender" doctrine that some courts use to evaluate the substance and economic reality of a lending arrangement to determine the actual lender. ▪ Preclude the Second Circuit or other courts from finding that the final rule is an incorrect interpretation and implementation of federal law. ▪ Promote or endorse the practice of partnering with a bank for the *sole* goal of evading a lower interest rate and related requirements, which the OCC continues to view unfavorably.

OCC Priorities under Acting Comptroller Brooks

In recent remarks, Acting Comptroller Brooks has outlined the priorities that he will pursue as interim head of the OCC, including:

- **Defending the proposed fintech charter.** To promote responsible innovation, the OCC will defend its authority to issue bank charters that support companies' ability to engage in the business of banking on a national scale, including taking deposits, lending money or paying checks. The OCC's proposed fintech charter has been challenged in court by the New York Department of Financial Services, and the Southern District of New York in

October 2019 entered a final judgment against the OCC preventing the agency from chartering any fintech applicants. The case is on appeal, and whether the Second Circuit will come to a different conclusion remains unclear (please see our prior **alert** for more details).

- **Clarifying (and possibly expanding) the parameters of the fintech charter.** Acting Comptroller Brooks noted that the agency would work to specify what the parameters of the fintech charter and other special purpose charters should be. In remarks prior to becoming Acting Comptroller, Brooks suggested that the OCC should consider the viability and utility of a non-depository payments charter to complement the non-depository lending charter that was the original concept behind the fintech charter. Brooks suggested that such charter type might be appropriate for payments companies and certain blockchain and digital asset projects.

- **Clarifying "true lender" status.** The OCC declined to address in its final rule which entity is the "true lender" in certain bank-fintech partnership models. Acting Comptroller Brooks separately stated that the OCC will work to clarify what "true lender" means, indicating the OCC does intend to address the issue. Similar to the uncertainty caused by the *Madden* decision, "true lender" litigation significantly increases legal and business risks for non-banking entities purchasing loans originated by banks, as successful "true lender" challenges expose the non-bank entity to significant penalties for usury and unlicensed lending and threaten the validity and enforceability of underlying loans under state law.

- **Building upon responsible innovation.** Acting Comptroller Brooks stated that the OCC should "support banks' use of new technology, products and models that safely and fairly accelerate the velocity of money, create greater financial inclusion, and empower consumers and businesses with more control over their financial affairs," noting innovation as one of his personal passions.

- **Fair access to the financial system**. Acting Comptroller Brooks also said that fair access to financial services "has come under attack" through Operation Choke Point and reputation risk-related practices. He also stated that the OCC would not tolerate lawful entities being denied access to the federal banking system based on popularity, an apparent response to concerns of some lawmakers and administration officials that many global banks have stopped investing in certain industries due to shareholder pressure.

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