DREHER TOMKIES LLP

ALERT

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OCC AND FDIC FINALIZE RULES TO ADDRESS *MADDEN*

On June 2nd, the Office of the Comptroller of the Currency ("OCC") published a final rule clarifying that the permissible interest rates on loans under 12 U.S.C. § 85 (national banks) or 12 U.S.C. § 1463(g)(1) (savings associations) will not be affected by the sale, assignment or other transfer of the loans. On June 25th, the Federal Deposit Insurance Corporation ("FDIC") finalized a substantially similar rule under 12 U.S.C. § 1831d (FDIC-supervised state banks), which clarified that the permissible interest rate on a bank loan is determined when the loan is made and is not affected by a change in state law, a change in the commercial paper rate (after the loan is made) or the subsequent sale, assignment or transfer of the loan.

The OCC's and FDIC's clarifying rules are responses to the U.S. Court of Appeals for the Second Circuit's 2015 decision in *Madden v. Midland Funding*, which created legal uncertainty regarding (i) the interest rate that a nonbank loan purchaser may charge on a bank loan and (ii) the continued prominence of the so-called "valid-when-made" doctrine. The legal uncertainty from the case has hampered originating lenders' abilities to sell whole loans, receivables or participations into the secondary market.

Upon finalizing, the OCC and FDIC did not materially change the text from the proposed rules. In the discussions accompanying each final rule, OCC and FDIC each responded to commentators challenging their authority to issue a rule. Unsurprisingly, the regulators took the position that they have ample authority under federal banking law to promulgate the rules because Sections 85, 1463 and 1831d are silent regarding the permissible interest rate on after a loan is transferred. In the face of statutory silence, the regulators interpreted these sections to provide legal certainty that the interest rate permitted before a loan transfer continues to be permissible after the transfer. The regulators viewed the final rules as promoting safe and sound operations of banks by protecting a bank's ability to manage its liquidity risk through loan sales. The FDIC also discussed its rule's importance to the broader banking system. The Deposit Insurance Fund could be adversely affected if the FDIC must sell a failed bank's large loan portfolio at a deep discount because of interest rate uncertainty.

The regulators specifically addressed the "valid-when-made" doctrine and whether the *Madden* decision foreclosed the regulators' abilities to issue rules on the permissible interest rate after bank loan transfers. Both regulators emphasized that the rules are based on fundamental interpretations of Sections 85, 1463 and 1831d, not on the "valid when made" doctrine and the assignability of contracts. However, the final rules are consistent with these common law doctrines and the doctrines helped inform the regulators' interpretations of the statutory sections. Neither regulator believed that the *Madden* decision precludes it from promulgating a rule on the permissible interest rate on bank loan transfers because the Second Circuit's holding did not rely on or interpret Section 85.

In finalizing the rule, the OCC and FDIC rejected calls from commentators to incorporate a "true creditor" test into the rules. The OCC and FDIC also rejected concerns from commentators that the rules would facilitate predatory lending through "rent-a-charter" relationships between banks and nonbanks.

The OCC's rule becomes effective in August and the FDIC's rule becomes effective 30 days after it is published on the federal register. The OCC's and FDIC's rules are intended to function the same way and maintain parity between state banks and national banks with respect to interest rate authority.

The OCC's and FDIC's rules promise welcome legal certainty regarding the interest rate that may be charged on bank loan transfers. However, it is possible that the regulators' rules could face court challenges or repeal by Congress under the Congressional Review Act.

The FDIC and OCC's rules have a significant limitation — the rules apply only to loans made by supervised depository institutions. The rules do not provide direct legal relief to nonbank lenders that sell whole loans to third parties. Plaintiffs and regulators may still try to use *Madden* to challenge the interest rate on nonbank loan transfers. ❑

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