GT GreenbergTraurig

Alert | Financial Regulatory & Compliance

July 2020

FDIC Follows OCC Lead in Attempt to Clarify Madden Uncertainty

On June 25, 2020, the Federal Deposit Insurance Corporation (FDIC) issued a final rule that attempts to resolve the legal uncertainty created by the 2015 holding of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). The FDIC's Final Rule follows the May 29, 2020, issuance of a similar rule by the Office of the Comptroller of the Currency (OCC).

Madden held that a non-bank purchaser of charged-off debt from a national bank seller could not inherit the preemptive interest rate authority enjoyed by national banks under Section 85 of the National Bank Act, 12 U.S.C. § 85. In reaching its holding, the Second Circuit reasoned that, rather than significantly interfering with a national bank's exercise of its powers, the application of state usury laws to the third-party assignee "would limit[ ] only activities of [a] third party which are otherwise subject to state control … and which are not protected by federal banking law or subject to OCC oversight." Thus, the decision in *Madden* called into question the enforceability of the interest rate terms of loan agreements following a national bank's assignment of one or more loans to a non-bank assignee.

The OCC's Final Rule sought to resolve the legal uncertainty resulting from *Madden* by clarifying that when a "[national] bank transfers a loan, [the] interest permissible before the transfer continues to be permissible after the transfer." Pursuant to the OCC's Final Rule, national banks and saving associations may transfer their loans without impacting the permissibility or enforceability of the interest term.

In its analysis accompanying the OCC's Final Rule, the OCC stated that its interpretation relies on the "cardinal rules in the doctrine of usury" that establish the broad proposition that "[t]he usurious or non-usurious character of a contract endures through assignment." The OCC also noted that its interpretation is supported by "national banks' ability to assign contracts and operate lending programs on a nationwide basis" consistent with the purposes of Section 85. Additionally, because national banks continue to rely on loan transfers to access alternative funding sources and to manage certain operational risks, the OCC believes that its interpretation also promotes safety and soundness, which is a core component of the OCC's mission as the prudential regulator of national banks.

The FDIC's Final Rule provides that the interest rate for a loan is determined when the loan is made and will not be affected by subsequent events such as changes in state law or a subsequent sale, assignment, or other transfer of the loan. The rule is applicable to state-chartered banks and insured branches of foreign banks. Consistent with its initially proposed rule, the FDIC's Final Rule "does not purport to allow State Banks to assign the ability to preempt State law interest rate limits" under federal law. Rather, its final rule merely allows State Banks "to assign loans at their contractual interest rates…"

Both the FDIC and OCC specifically chose not to address "which entity is the true lender when a bank transfers a loan to a third party." In adopting its final rule, the OCC declined to include a regulatory text providing that the final rule does not affect the determination of which entity is the true lender. Additionally, because the final rule only applies to bank loans that are permissible under Sections 85 or 1463(g), the OCC also declined to include a provision that the final rule only applies when the bank is the true lender.

The OCC's Final Rule is effective August 3, 2020. The FDIC's Final Rule will be effective thirty days from the date of publication of its final rule in the Federal Register.

Authors

This GT Alert was prepared by:

- Carl A. Fornaris | +1 305.579.0626 | fornarisc@gtlaw.com
- Gil Rudolph | +1 202.530.8575 | rudolphg@gtlaw.com
- Jennifer D. Newton | +1 305.579.0584 | newtonj@gtlaw.com