

Chapman Client Alert

July 24, 2020

Current Issues Relevant to Our Clients

Recent Regulatory Actions Focus on Technology and Innovation

The Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”) have been quite active in issuing or proposing new regulations and initiatives focused on financial technology (“Fintech”) and innovation in financial services.

“Valid When Made” Regulations Become Effective in August

In November 2019, both the OCC and FDIC issued proposed regulations that would codify the long-standing legal principle that a loan that is “valid when made” does not become invalid when sold, transferred, or assigned. After a public comment period, both agencies adopted as a final regulation a substantially similar rule clarifying that interest permissible on a loan at the time it is made is not affected by the sale, assignment, or transfer of the loan, even if to a non-bank assignee. The OCC’s rule becomes effective August 3, 2020.¹ The FDIC rule becomes effective August 21, 2020.²

Both agencies expressed the view that the interest statutes for national and state banks were ambiguous creating uncertainty that was fueled by the appellate court decision in *Madden v. Midland*.³ The rules would alleviate such uncertainty and provide market stability. Both agencies went to great lengths to explain their rulemaking and why it was not subject to the Administrative Procedure Act⁴, a pre-emption determination or that the rule would result in predatory lending. Rather each agency expressed displeasure with entities that attempted to use banks to evade interest rate restrictions.

Under the *Chevron* doctrine⁵ 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 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.⁶

OCC Proposes True Lender Regulation

On July 22, the OCC issued a Notice of Proposed Rulemaking related to who is the true lender on a loan.⁷ In short, simple, and succinct fashion, the OCC states that as of the date of loan origination the true lender is either the party named as lender on the loan agreement or the entity that funds the loan. The agency indicated that this rulemaking is in the context of partnerships with third parties including marketplace lending. The OCC emphasized the piecemeal and divergent court decisions on the subject, which neither clear or dispositive, have created uncertainty and discouraged third party lending relationships and limited competition. The OCC emphasized the need for predictable and stable markets that will allow for the continued availability of public credit. If enacted, this bright line test would provide a clear path to resolving the current existing ambiguities and confusing precedent. The proposal is subject to a public comment period until September 3, 2020 after which time the OCC will evaluate the comments and determine whether or not to proceed with a final rule.

Interestingly, in an online webinar sponsored by the Online Lending Policy Institute⁸ the Chairman of the FDIC indicated that the FDIC may not merely tag along with the OCC on this initiative but will wait and see what transpires as a result of the public comments and then determine how to proceed.

OCC Seeking to Modernize Digital Activities Regulation

On June 4, 2020 the OCC issued an Advance Notice of Proposed Rulemaking related to the digital activities of national banks and federal savings associations.⁹ This promulgation seeks input on revising and modernizing the existing provisions of the Code of Federal Regulations related to electronic and technological aspects of banking. It is part of the OCC’s push

to foster the use of innovation and technology in banking. The public comment period is short, ending on August 3, 2020.

The 11 questions posed by the OCC ask commenters to address new aspects of digital activities and whether regulation would be beneficial or burdensome to things such as digital finder activities, sale of software, cryptocurrency, distributive ledger technology, use of artificial intelligence and machine learning, payment technologies, regtech, other activities and changes due to the COVID-19 pandemic. However, the OCC stated that this initiative is not to comment on special purpose national banks related to Fintech.

FDIC RFI Relating to Standards and Voluntary Certification

On July 20, 2020, the FDIC put out a Request for Information (“RFI”) as part of its efforts to promote new technology in banking. The RFI poses 26 questions asking for comments on the use of a standard setting organization (“SSO”) and voluntary certification of credit models and third-party service providers. The RFI is aimed at making it easier for smaller community banks which the FDIC supervises to utilize modern technology in their banking operations. Smaller banks face high start-up costs and barriers to entry that could be mitigated by use of models or service providers that meet certain standards or achieve certification. These standards and certifications would not replace existing guidance but provide short cuts to vendor management and due diligence processes. Comments are due 60 days after publication in the Federal Register. Chapman partner Marc Franson discussed the RFI with two senior officials at the FDIC. This discussion, sponsored by the Online Lending Policy Institute, is available on our website: www.chapman.com.¹⁰

OCC Approves Custody of Cryptocurrency

On July 22, 2020, the OCC issued an interpretive letter authorizing national banks and federal savings associations to provide cryptocurrency custody services to customers.¹¹ The OCC discussed the nature of cryptocurrency and that the underlying asset is accessed by holding unique cryptographic keys, which if lost are irreplaceable. As a result, there is a need for safe storage of those keys. The OCC states that national banks and federal saving associations may provide banking services to any lawful business so long as the institution can manage the risk and comply with applicable law. Further, banks have the authority to provide custody of physical and electronic assets and safekeeping is a basic banking service. The OCC supports electronic provision of traditional safekeeping services whether in a fiduciary or non-fiduciary capacity and places no prohibition so long as the bank is capable of providing the service and the asset is legal. The OCC also notes that possession of the cryptographic keys is not the same as being in possession of the asset itself. The OCC allows its regulated institutions to do by electronic means any authorized activity.¹²

Endnote

The federal banking agencies continue to promote innovation and the use of technology in financial services products and services. These recent actions are examples of efforts in this arena.

For More Information

If you would like further information concerning the matters discussed in this article, please contact the Chapman attorney with whom you regularly work.

- 1 85 Federal Register 33530 (June 2, 2020), to be codified at 12 C.F.R. 7.4001(e).
- 2 85 Federal Register 44146 (July 22, 2020), to be codified at 12 C.F.R. 33.4(e).
- 3 786 F.3d 246 (2d Cir. 2015) cert. denied, 136 S.Ct. 2505 (2016).
- 4 5 U.S.C. 551 et seq.
- 5 Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984).
- 6 5 U.S.C. 8001 et seq.
- 7 85 Federal Register 44223 (July 22, 2020) to be codified at 12 C.F.R. 7.1031.
- 8 This interview is available on our website: www.chapman.com

- 9 85 Federal Register 40827 (July 7, 2020) to be codified at 12 CFR Parts 7 and 155. On the same day, the OCC also issued a notice of proposed rulemaking related to bank operations which although not directly related to financial technology would help facilitate innovative technologies and digital activities.
- 10 Discussion with Brandon Milhorn, Chief of Staff to the FDIC Chairman and Leonard Chanin, Deputy to the Chairman of the FDIC.
- 11 OCC Int. Ltr. 1170 (July 22, 2020).
- 12 12 C.F.R. 7.5002(a).

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors. © 2020 Chapman and Cutler LLP. All rights reserved. Attorney Advertising Material.