

# Chapman Client Alert

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Current Issues Relevant to Our Clients

## OCC Issues Final Rule on "Valid When Made"

On Friday May 29, 2020, the Office of the Comptroller of the Currency ("OCC") 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 will become effective 60 days after publication in the Federal Register, or sometime in early August. While this regulation is intended to clarify the agency's position relative to the Second Circuit decision of *Madden v. Midland Funding, LLC*, 786 F.3d 246, cert. denied, 136 S.Ct.2505 (2016) 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") has issued a similar rule that would apply to state chartered banks that is awaiting finalization which 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 when it becomes final) 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. 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 assign contracts and the character and terms of a contract endures its assignment. In other words,

interest terms shouldn't 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 didn't 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.

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 anticipated FDIC rule to follow is 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.

### [For More Information](#)

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