District Court Upholds OCC and FDIC 'Valid When Made' Rules

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On February 8, 2022, a federal district court in California issued two opinions, granting summary judgment to the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) and rejecting challenges by eight states (Plaintiffs) that the agencies' "valid when made" rules facilitated predatory lending and were invalid under the Administrative Procedures Act.[1] The rules essentially codified the doctrine that, if an interest rate was legal when the loan was made by a bank, that rate remains legal after the sale, assignment or other transfer of the loan.[2]

The OCC and FDIC issued their rules in response to the Second Circuit's holding in *Madden v. Midland Funding, LCC*,[3] where a national bank sold credit card debt to a non-bank debt buyer. A debtor filed a putative class action against the buyer's affiliate for collecting on the account, including interest at a rate that exceeded New York's usury law. The debtor argued that once the debt was sold by the bank, interest rate preemption under the federal banking laws no longer applied and state law governed.[4] The *Madden* court rejected the debt collector's preemption defense, holding that, where the activities of a national bank would not be significantly interfered with, such as when the bank no longer has any interest in or control over the debt, the third party to which the loan was assigned could not invoke usury preemption under federal banking law.

The *Madden* decision created substantial uncertainty for both banks selling loans and non-banks buying loans regarding whether the interest rate would continue to be legal after the sale. The OCC and FDIC "valid when made" rules sought to provide certainty that the original interest rate would remain legal after the sale regardless of state usury laws.

However, the Plaintiffs alleged that the rules allow non-bank lenders to evade caps on interest rates imposed by states to combat predatory lending to consumers. The Plaintiffs claimed that non-bank lenders had formed sham "rent-a-bank" partnerships with banks in which the bank originates the loan, then transfers it to the non-bank lender so that the relevant state interest rate cap was not applied. The Plaintiffs challenged the rules under the Administrative Procedures Act.

The district court applied *Chevron* deference to the agencies' interpretations of the federal banking laws and upheld the rules.[5] It determined that the OCC and the FDIC had acted within their authority and in line with prior congressional guidance when promulgating their rules. The court further held that the OCC and the FDIC had reasonably interpreted the statutes and related rulemaking, and that their rulemaking was not "arbitrary" or "capricious," since the record did not indicate that the agencies had failed to consider potential problems that could arise from the rules.

[1] *People of the State of California, et al., v. Federal Deposit Insurance Corp.*, No. 20-cv-05860-JSW (N.D. Cal. Feb. 8, 2022); *People of the State of California, et al., v. The Office of the Comptroller of the Currency, et al.*, No. 20-cv-05200-JSW (N.D. Cal. Feb. 8, 2022). The lawsuit against the FDIC was filed by California, the District of Columbia, Illinois, Massachusetts, Minnesota, New Jersey, New York and North Carolina. The lawsuit against the OCC was filed by California, Illinois and New York.

[2] The OCC's rule is "Permissible Interest on Loans That are Sold, Assigned, or Otherwise Transferred," 85 Fed. Reg. 33,530 (June 2, 2020). The FDIC's rule is "Federal Interest Rate Authority Rule," 85 Fed. Reg. 44,146 (July 22, 2020).

[3] 786 F.3d 246 (2d Cir. 2015).

[4] Under the National Bank Act of 1864 and the Home Owners' Loan Act of 1933, national banks are not subject to other states' caps on interest rates, and can "export" their home states' interest rates to states where their borrowers live, and state law claims of usury against national banks are preempted.

[5] The court's "*Chevron* analysis" refers to a legal test set forth by the Supreme Court in *Chevron U.S.A. v. Natural Resources Defense Council* to determine when the court should defer to an agency's interpretation of a statute. 467 U.S. 837 (1984).

In responding to the court ruling, Acting Comptroller Hsu stated: "This legal certainty should be used to the benefit of consumers and not be abused. I want to reiterate that predatory lending has no place in the federal banking system. The OCC is committed to strong supervision that expands financial inclusion and ensures banks are not used as a vehicle for 'rent-a-charter' arrangements."

Such arrangements are a concern to House Financial Services Committee Chair Maxine Waters (D-Calif.), who has identified "combating rent-a-bank schemes that hurt consumers" as a priority for the committee.[6] At present, however, no legislation is advancing in Congress to address the *Madden v. Midland* decision or the OCC or FDIC rules.

[6] In a prior Congress, Chair Waters opposed legislation to codify the valid-when-made doctrine. At the time, she stated: "We cannot advance a bill that will allow nonbanks like payday lenders to ignore state interest rate caps and make high-rate loans. While Congress has preempted some state laws for national banks, it did not authorize national banks to extend the privilege to whatever entities they so choose."

It is important to note that the district court's decision is subject to potential appeal. Also, the ruling does not address potential challenges to bank partnership models under a so-called "true lender" theory. Under that theory, some plaintiffs and states have sought, with mixed success, to assert that the relationship between a bank and a non-bank (often a fintech) platform is one where the non-bank is the "true lender" in the transaction, and thus federal interest rate and licensing preemption does not apply. But, despite these limitations, the ruling is an important step in providing further certainty to the financial services industry regarding business models involving loans acquired from banks.

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