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LEGAL UPDATES AND NEWS

OCC Final Rule on Permissible Interest on Transferred Loans

The Office of the Comptroller of the Currency ("OCC") recently issued a final rule clarifying that when a national bank or federal savings association transfers a loan, the interest rate permissible before the transfer continues to be permissible after transfer. The final rule applies to national banks and federal savings associations and is effective on August 3, 2020.

I. **Background**

The final rule is designed to provide clarity in view of a 2015 decision of the United States Court of Appeals for the Second Circuit, *Madden v. Midland Funding, LLC*. In *Madden*, the court ruled that the purchaser of a loan originated by a national bank could not charge the interest rate charged by the selling bank if that rate would be prohibited under a lower usury rate applicable to the purchaser. The *Madden* decision was contrary to the OCC's traditional interpretation and the preamble to the OCC's final rule indicated that uncertainty arising from the *Madden* decision may disrupt a bank's ability to serve consumers, businesses and the broader economy efficiently and effectively, particularly in times of economic stress. The OCC also noted that clarifying the issue may "facilitate responsible lending by banks including in circumstances when access to credit is especially critical."

II. **The Basis for the OCC's Final Rule**

The preamble to the OCC's final rule notes the statutory authority in federal law for national banks to both make and assign loans. National banks are authorized by 12 U.S.C. §85 to charge interest on loans at the rate allowed by the laws of the state where the bank is located (which is generally the state in which the main office is located) and to export that rate to borrowers located in other states. However, no federal statute specifically addresses how the transfer of the loan affects the interest charged.

The OCC rejected comments submitted in response to its November 2019 proposed rule on this subject which argued that it had no authority to adopt the final rule. The OCC referred to Supreme Court precedent that authorized a federal regulatory agency to adopt its own interpretation of a silent federal statute so long as it is a permissible construction of the statute. In that regard, the OCC pointed to the longstanding common law "valid-when-made" principle, i.e., that a loan is valid when made for purposes of usury laws, including in case of assignment. Also pertinent to the OCC's view is the authority of national banks to assign contracts. Caselaw has recognized that the assignee "steps into the shoes" of the assigning bank, which the OCC concluded includes the transferred interest rate. The OCC indicated that it believes its interpretation is consistent with the goal of federal usury laws to facilitate a national bank's ability to engage in lending on a nationwide basis by providing uniformity in applicable interest law.

The OCC also noted that the issue implicates safety and soundness concerns since many banks engage in loan transfers to "access alternate funding sources, manage concentrations, improve financial performance ratios, and more effectively meet customer needs." The OCC suggested that the uncertainty arising from the *Madden* case impaired a bank's ability to employ loan sales as a risk management tool, which it viewed as particularly troublesome in times of economic stress when funding and liquidity concerns may be most pressing. The OCC indicated that its final rule in no way changed its opposition to predatory lending, including through banks' relationships with non-banks.

Federal savings associations are governed by a separate but similar federal statue with respect to usury. As noted above, the OCC's final rule applies equally to loan transfers by federal savings associations.

III. Potential Final Rule Applicable to State Banks

A provision of the Federal Deposit Insurance Corporation Act adopted in 1980, 12 U.S.C. §1831d, establishes the maximum interest rate that all federally-insured state-chartered institutions may charge. The statute is similar to 12 U.S.C. §85, the usury statute applicable to national banks, and has generally been construed by the Federal Deposit Insurance Corporation ("FDIC") in the same manner as OCC interpretations of the national bank usury statute.

In November 2019, the FDIC issued its own proposed rule that would implement 12 U.S.C. §1831d. The proposal included codifying the FDIC's longstanding interpretation that the permissible interest rate on a loan, as permitted where the institution is located, would be unaffected by subsequent events including assignment of the loan.

Similar to the OCC, the FDIC's stated primary purpose in issuing its proposed rule was to eliminate the legal uncertainty caused by the *Madden* decision and thereby facilitate loan sales by state-chartered institutions. The FDIC indicated that such uncertainty may hinder loan sales which it considers "crucial" to safety and soundness in terms of the ability to increase liquidity in times of crisis, meet unusual deposit withdrawal demands or pay unexpected debt. The FDIC also noted the importance of loan sales in avoiding excessive concentrations and meeting increased credit demand.

The FDIC has not adopted a final rule as of this writing but its customary practice of interpreting 12 U.S.C. §1831d similarly to OCC interpretations of 12 U.S.C. §85 suggests that such a final rule will be forthcoming.

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