OCC Issues Final Rule Clarifying the “Valid When Made” Doctrine

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On June 2, 2020, the Office of the Comptroller of the Currency (the “OCC”) published its final rule (the “Rule”), clarifying that an assignee of a national bank has the right to collect interest at the same rate as the national bank on loans made by the national bank. The Rule, which codifies the common law doctrine of “valid when made,” will be effective August 1, 2020.

Background
The National Bank Act (the “NBA”) provides national banks with various powers, including the power to lend money, transfer loans, and enter into contracts. In the release announcing the Rule, the OCC has determined that implied in the power of a national bank to enter into contracts is the right to assign part or all of the benefits of a contract to a third party. The NBA also authorizes the bank to charge interest at the highest rate permitted by the state in which the bank is located. Thus, a national bank possesses the authority to enter into a loan contract with an interest rate consistent with the laws of the state in which it is located, and to assign that loan contract at any time thereafter. The NBA is silent, however, as to the effect of the assignment on the permitted interest rate.

The Final Rule
The Rule fills the gap by providing that the interest rate is unaffected by the assignment of the loan contract. In doing so, the Rule follows the “valid when made doctrine,” which holds that a loan that was valid when made will not be rendered usurious by a subsequent transfer. In addition to national banks, the Rule applies to federal savings associations.

The Rule is intended to address the legal uncertainty created by the Second Circuit’s decision in Madden v. Midland Funding, LLC. In Madden, the plaintiff argued that a debt collector violated New York usury law by charging and then attempting to collect interest at a rate higher than permitted under New York law. The debt collector had purchased the plaintiff’s debt from a national bank located in Delaware, which allows a creditor to charge a higher interest rate than does New York. In reversing the District Court’s dismissal of the case, the Second Circuit held that the debt collector could not rely on the protections afforded by the NBA because it was neither a national bank nor an agent of a national bank. During the comment period on what would become the Rule, numerous commenters criticized Madden, arguing that it resulted in negative effects on the primary and secondary markets for bank loans. In promulgating the Rule, the OCC responded to this argument, stating that the Rule will help banks to manage their liquidity, thereby promoting safe and sound banking practices in the market.

2 12 U.S.C. 24 (Seventh) and 371.
4 12 C.F.R. 7.4001 (national banks); 12 C.F.R. 160.110 (savings associations).
5 Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015).
6 Id. at 248.
7 Id. at 250.
8 Id. at 249.
Still, some commenters questioned whether the OCC possessed the legal authority to issue the Rule. In doing so, they echoed recent U.S. Supreme Court rulings that call into question the level of deference federal courts should give to regulatory interpretations.⁹ Considering the vigorous litigation regarding this issue of agency deference, it is possible that an aggrieved debtor will challenge the Rule, contending that it exceeds the OCC’s authority. Anticipating such an attack, the release includes a detailed discussion of the OCC’s legal justification for its authority, together with the basis for its determination that the Rule reasonably interprets the NBA.

Unresolved Questions
While the Rule provides needed clarification for participants in the loan markets, it does leave unanswered questions. Because it applies only to national banks and federal savings associations, the Rule does not cover other federally insured banks. The Federal Deposit Insurance Corporation (the “FDIC”) is considering a similar rule, which if adopted in substantially the same form, would apply the “valid when made” doctrine to assignees of state-chartered banks insured by the FDIC. The FDIC first announced its proposed rule on November 19, 2019, but has not yet acted on it. Consequently, assignees of state-chartered banks insured by the FDIC do not yet have the benefit of a specific federal regulation confirming the “valid when made” doctrine.

The Rule also does not address whether a national bank should be considered the “true lender” in a transaction where the loan is assigned to the assignee soon after it is made pursuant to an agreement between the national bank and the assignee. Commenters requested that the Rule create that additional safe harbor, but the OCC declined to act on the request. Therefore, we may reasonably expect “true lender” attacks on specific types of loan transactions to continue.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the authors.

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