Schulte Roth&Zabel

Alert

FDIC Finalizes Rule Clarifying Validity of Interest Rates on Assigned Bank Loans Following Second Circuit Ruling in *Madden v. Midland Funding LLC*

June 30, 2020

On June 25, 2020, the Federal Deposit Insurance Corporation ("FDIC") finalized a rule[1] to clarify that when state-chartered banks sell, assign or otherwise transfer a loan, an interest rate that is permissible before such transfer remains permissible following the transfer ("FDIC Final Rule").[2] The FDIC Final Rule addresses the uncertainty created by the U.S. Court of Appeals for the Second Circuit's 2015 ruling in *Madden v. Midland Funding, LLC*[3] which threw into doubt the validity of interest rates on bank loans sold to fintech lenders or other nonbank third parties. The FDIC Final Rule follows a matching rule finalized by the Office of the Comptroller of the Currency on May 29, 2020 ("OCC Final Rule") and summarized in our *Alert* published on the same day.[4]

While the OCC Final Rule looked to the National Bank Act[5] and the Home Owners' Loan Act[6], the FDIC Final Rule relies on Section 27 of the Federal Deposit Insurance Act[7] ("FDI Act"). The Final Rule provides that state-chartered banks are authorized to charge interest at the rate permitted by the state in which the bank is located, or one percent in excess of the ninety-day commercial paper rate, whichever is greater. The FDIC Final Rule further provides that whether interest on a loan is permissible under Section 27 of the FDI Act is determined at the time the loan is made, and interest on a loan permissible under Section 27 is not affected by a change in state law, a change in the relevant commercial paper rate, or the sale, assignment or other transfer of the loan.

Mirroring the OCC Final Rule, the FDIC Final Rule seeks to reinforce the common law principle of "valid-when-made," a doctrine relied upon by many banks and fintech lenders as a core component of their

---

[1] *See* https://www.fdic.gov/news/board/2020/2020-06-25-notice-dis-c-fr.pdf.

[2] In addition to state-chartered banks, the FDIC Final Rule also applies to insured U.S. branches of foreign banks. However, federal deposit insurance has not been available to U.S. branches of foreign banks since Dec. 19, 1991. While U.S. branches of foreign banks that obtained federal deposit insurance prior to that date were grandfathered in, very few such branches still exist.

[3] 786 F.3d 246 (2d Cir. 2015). In this case, the U.S. Court of Appeals for the Second Circuit held that a nonbank purchaser of a loan originated by a national bank could not charge interest at the rate permissible for the bank if that rate would be impermissible under the lower usury cap applicable to the purchaser.

[4] *See* https://www.srz.com/resources/occ-finalizes-rule-to-undo-second-circuit-ruling-in-madden-v.html.

[5] 12 U.S.C. §85.

[6] 12 U.S.C. §1463(g).

[7] 12 U.S.C. §1831d.

business models. The doctrine provides that loans which are non-usurious at origination do not subsequently become usurious when assigned.

Acting FDIC chairman Jelena McWilliams released a statement in support of the FDIC Final Rule, noting that "[t]he final rule accomplishes three important safeguards for the stability of our financial system by promoting safety and soundness, solidifying the functioning of a robust secondary market, and enabling the FDIC to fulfill its statutory mandate to minimize risk to the [Federal] Deposit Insurance Fund."[8]

Authored by *Joseph P. Vitale* and *Nicholas A. Wilson*.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

Schulte Roth & Zabel
New York | Washington DC | London
www.srz.com

This communication is issued by Schulte Roth & Zabel LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. In some jurisdictions, this publication may be considered attorney advertising. ©2020 Schulte Roth & Zabel LLP. All rights reserved. SCHULTE ROTH & ZABEL is the registered trademark of Schulte Roth & Zabel LLP.

[8] *See* https://www.fdic.gov/news/speeches/spjun2520b.html.