

## Alert

### **New York, California and Illinois Sue to Block OCC Rule That Would Undo *Madden v. Midland Funding LLC***

July 30, 2020

On July 29, 2020, New York, California and Illinois filed a lawsuit against the Office of the Comptroller of the Currency (“OCC”) over its final rule issued in May<sup>1</sup> clarifying that when a national bank or a federal or state savings association sells, assigns or otherwise transfers a loan, an interest rate that is permissible before such transfer remains permissible following the transfer (“Final Rule”). The lawsuit argues that the Final Rule will “dramatically expand preemption of state interest-rate caps, allowing not just [federally chartered banks] but any entity that buys their loans to charge interest in excess of rates permitted by state law.”

The states argue that the Final Rule “unlawfully extend[s] federal law in order to preempt state rate caps that would otherwise apply to ... non-bank entities.” The complaint alleges that the OCC “failed to follow the procedures set forth by Congress after the last financial crisis” for enacting OCC rules that preempt state consumer-protection laws, and that it ignored the requirement to consult with the Consumer Financial Protection Bureau prior to doing so.<sup>2</sup> The states further argue that the OCC does not have jurisdiction over the permitted activities of nonbanks and “impermissibly seeks to overturn a federal court’s construction of an unambiguous statute” that interest rate preemption does not extend to nonbanks.

As explained in more detail in our June 2, 2020 *Alert*, the Final Rule seeks to address the uncertainty created by the U.S. Court of Appeals for the Second Circuit’s 2015 ruling in *Madden v. Midland Funding, LLC*<sup>3</sup> which threw into doubt the validity of interest rates on bank loans sold to fintech lenders or other nonbank third parties. It reinforces the common law principle of “valid-when-made,” a doctrine relied upon by many banks and fintech lenders as a core component of their business models.

The Final Rule “protects the sanctity of legal contracts and provides the legal certainty to support the orderly function of markets and availability of credit,” OCC spokesman Bryan Hubbard told multiple

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<sup>1</sup> See “OCC Finalizes Rule to Undo Second Circuit Ruling in *Madden v. Midland Funding LLC*,” *SRZ Alert*, June 2, 2020, available here: <https://www.srz.com/resources/occ-finalizes-rule-to-undo-second-circuit-ruling-in-madden-v.html>. The Federal Deposit Insurance Corporation approved a similar rule in June clarifying 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. See also “FDIC Finalizes Rule Clarifying Validity of Interest Rates on Assigned Bank Loans Following Second Circuit Ruling in *Madden v. Midland Funding LLC*,” *SRZ Alert*, June 30, 2020, available here: <https://www.srz.com/resources/fdic-finalizes-rule-clarifying-validity-of-interest-rates-on.html>.

<sup>2</sup> See 12 U.S.C. § 25b.

<sup>3</sup> 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.

sources. “We are confident in our authority to issue a rule on this matter and look forward to defending that authority.”

The case is the *People of the State of California, Illinois and New York v. The Office of the Comptroller of the Currency and Comptroller Brian Brooks*, case number 20-cv-5200, filed in the U.S. District Court for the Northern District of California.

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

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