CENTER FOR CAPITAL MARKETS
COMPETITIVENESS®

Julie Stitzel
VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5339
jstitzel@uschamber.com

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Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E–218
Washington, DC 20219

Re: Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred

Dear Sir or Madam:

The U.S. Chamber of Commerce's ("the Chamber") Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the proposed rule ("Proposal") issued by the Office of the Comptroller of the Currency (the "OCC") regarding permissible interest on loans that are sold, assigned, or otherwise transferred.[1] Clear rules governing permissible interest can enable well-functioning capital markets.

Consumer credit enables countless Americans to achieve their dreams. Without access to credit, many Americans would find the path to a better life out of reach: they would be unable to buy homes, pay for their cars, finance their educations, or cover surprise expenses. National banks – i.e., banks chartered by the OCC, rather than by a State – serve consumers in each of these respects. To allow national banks to provide these services consistently across the country, Congress long ago made clear that federal law – not the laws of every state in which the bank may have operations – governs the interest rate that they may charge a consumer. Any other rule would be impractical. A national bank that had to comply with fifty different state usury laws in issuing loans would be a "national" bank in name only.

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[1] *See* Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64229 (Nov. 21, 2019).

Of course, compliance with interest rate laws when making loans is not the end of the story. Modern credit markets see loans change hands for many appropriate reasons. A national bank may assign a loan to a securitization vehicle for financing purposes, for example, transfer it to a debt collector to capture residual value in the loan, or sell a participation interest in a loan to help manage its capital requirements. In each case, such assignment benefits consumers by allowing national banks to serve them more effectively. Assignment for financing or capital management purposes enables banks to extend more credit, for example, and assignment for collections allows banks to keep the cost of credit low.

National banks are clearly authorized to transfer the loans they make for these and other purposes. But this authorization would mean little if the interest rate that could be collected under those loans became subject to state law upon assignment. Because the assignee would need to comply with state law (and thus only would want to be assigned compliant loans), a national bank effectively would have to manage compliance obligations under fifty state laws if it ever contemplated assigning the loans it made. As with compliance with state interest rate limitations upon the issuance of a loan, a national bank thus would be "national" in name only if the loans it made became subject to state law upon sale, assignment, or other transfer.

Congress, the courts, and the OCC unsurprisingly have rejected such an outcome. They instead have accepted the "cardinal rule" that a loan that is "valid when made" cannot become usurious upon assignment to a third party. As a result, it had long been settled law that an assignee of a loan issued by a national bank could collect the same interest rate that the national bank had agreed to with the consumer. This rule reflects basic principles of contract law and fundamental fairness as it means that a consumer borrower will pay the agreed-upon interest rate even if a loan is sold, assigned, or otherwise transferred.

As the OCC has correctly recognized, however, this well-established rule has been upended by the decision of the Second Circuit in *Madden v. Midland Funding, LLC*, 786 F.3d 2015 (2d Cir. 2015). The court ignored the longstanding "valid when made" rule when it held that an assignee of a valid credit card agreement violated state usury laws when attempting to collect on the agreement. The Second Circuit thereby overturned marketplace expectations, and legal precedent, thus creating enormous confusion that is hurting consumers – and that persists almost five years later. Despite a broad, bipartisan understanding that the decision was wrongly decided, however, neither the Supreme Court nor Congress have corrected the circuit court's error. As a result, it is critical that the OCC act now to correct the mistake made in *Madden* and allow credit markets to work as effectively as possible for American consumers.

We accordingly write to emphasize three points:

- The Second Circuit's decision in *Madden v. Midland Funding, LLC* was wrongly decided;
- The *Madden* decision is causing confusion in the marketplace and hurting consumers;
- The OCC should issue a final rule that fixes the problems caused by the *Madden* decision.

Discussion

I. The Second Circuit's decision in *Madden v. Midland Funding, LLC* was wrongly decided.

A. The longstanding "valid when made" rule is incorporated into the National Bank Act and is intended to facilitate a national credit market that serves American consumers.

It is a cardinal rule of usury law that a loan that is "valid when made" cannot become usurious upon its transfer to another entity. For example, the Supreme Court explained in 1828 – almost two-hundred years ago – that "the rule cannot be doubted, that if the note is free from usury, in its origin, no subsequent usurious transactions respecting it, can affect it with the taint of usury." *Gaither v. Farmers & Mechs. Bank of Georgetown*, 26 U.S. 37, 43 (1828). Five years later, the Supreme Court confirmed that it was a "cardinal rule" of usury law that the determination of whether a loan is usurious occurs at the time of origination. *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833). As the Supreme Court explained, any other rule would mean that "a contract, wholly innocent in its origin, and binding and valid, upon every legal principle, [would be] rendered, at least, valueless, in the hands of the otherwise legal holder." *Id.* at 110.[2]

[2] Moreover, other American and English courts had recognized this cardinal rule well before the Supreme Court's decisions in *Gaither* and *Nichols*. *See, e.g., Watkins v. Taylor*, 16 Va. 424, 436 (1811) ("[I]f it was not usury at the time when the contract was entered into, no after circumstance can make it so; and any argument, therefore, drawn from after circumstances, would be improper." (emphasis in original)); *Tuttle v. Clark*, 4 Conn. 153, 157 (1822) (holding that "this note, free from the taint of usury, in its origin," did not become usurious by the subsequent sale); *Tate v. Wellings*, 100 Eng. Rep. 716, 721 (K.B. 1790) (opinion of Buller, J.) ("Here the defence set up is that the contract itself was illegal; and in order to support it, it must be shewn that it was usurious at the time when it was entered into; for if the contract were legal at that time, no subsequent event can make it

Congress legislated against this backdrop when it provided that the interest rate that a national bank may charge upon a loan is governed by federal law – not state usury laws. Specifically, the National Bank Act provides that a national bank "may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located," or a rate at one percent above the Federal Reserve discount rate, whichever is higher. 12 U.S.C. § 85. Congress provided an exclusive federal cause of action for violations of this interest rate limit. 12 U.S.C. § 86. *See also Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003) (holding that Section 86 completely preempts state usury law). The National Bank Act also authorizes national banks to assign loans. 12 U.S.C. § 24 (Seventh).

"[W]here a common-law principle is well established," Congress is understood to have "legislated with an expectation that the principle will apply 'except when a statutory purpose to the contrary is evident.'" *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991) (quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952)) (internal quotation marks and citations omitted)). As discussed above, the "cardinal rule" that a loan that is "valid when made" does not become usurious upon assignment was firmly entrenched in American jurisprudence by the time of Congress's enactment of Section 85 in 1864. As a result, Section 85 is properly understood to incorporate the "valid when made" rule. This certainly has long been the understanding prevailing in the credit markets, which have always functioned on the premise that the "valid when made" rule was incorporated into and formed an integral part of Section 85.[3] Loans have been routinely purchased and sold for hundreds of years on this understanding: it has always been a given that loans validly originated by a national bank could be sold or transferred without a buyer becoming subject to state-law usury claims.

Congress of course had the power to change this understanding at any time by rejecting the "valid when made" rule. It did not do so, however, for a simple reason: this was precisely the outcome that Congress expected and intended in creating Section 85 in the first place. Congress intended to enable a thriving nationwide credit market—on which countless consumers could depend—to grow based on the certainty provided by the "valid when made" rule. And Congress likewise understood that it would disrupt fundamental principles of contract law and basic fairness if transfer of a loan somehow changed the applicable interest rate that a borrower was

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usurious."); *see also* 1 William Blackstone, Commentaries on the Laws of England 379-80 n.32 (18th London ed., W.E. Dean 1838) ("The usury must be part of the contract in its inception . . . .").

[3] As discussed below, the existence of this longstanding expectation was confirmed by the changes seen in the credit markets after the *Madden* decision was issued.

obliged to pay. Congress thus continued to support the stability and certainty provided by the "valid when made" rule. Indeed, as the OCC and the Federal Deposit Insurance Corporation ("FDIC") recently explained: "The valid-when-made rule has withstood the test of time because it is compelled by commercial needs, fundamental fairness, and general principles of contract law." Amicus Brief of the FDIC and the OCC 12, *In re: Rent-Rite Super Kegs West Ltd.*, No. 19-cv-01552 (D. Colo. Sept. 10, 2019).

B. The Second Circuit's *Madden* decision ignored the "valid when made" rule and conflicted with decisions of other courts of appeals.

The "valid when made" rule made no appearance in the Second Circuit's *Madden* decision despite its two-hundred year pedigree. The court thus failed to ground its decision in the legal principle – long-established under usury common law and incorporated into the National Bank Act – that should have governed the case. Unsurprisingly, other circuit courts to have considered the issue did not make the same mistake. Instead, each court of appeals to have considered the question before *Madden* explained that a valid loan cannot be rendered usurious merely by being transferred to a third party.

In *FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981), for example, a national bank in Tennessee obtained an interest in a loan made to a Georgia corporation. Although it was undisputed that the loan was not usurious when made under Georgia law, the plaintiff argued that a national bank based in Tennessee was subject to the more restrictive usury laws of that state once it obtained an interest in the loan. The Fifth Circuit cited the Supreme Court's "cardinal rule" decision in *Nichols*, however, and rejected the borrowers' argument. It correctly explained that "[t]he non-usurious character of a note should not change when the note changes hands." *Id.* at 148-49.

The Eighth Circuit likewise relied on the "valid when made" rule in a case involving a department store that had purchased receivables from credit cards originated by a national bank. *See Krispin v. May Dep't Stores Co.*, 218 F.3d 919, 921-24 (8th Cir. 2000). The borrowers in that case alleged that late fees charged were usurious under Missouri law. The court of appeals concluded that Section 85 preempted their claims, holding that a court must "look to the originating entity (the bank) and not the ongoing assignee (the store) in determining whether the [National Bank Act] applies." *Id.* at 924 (citing the Fifth Circuit's decision in *Lattimore*, discussed above). The Eighth Circuit has subsequently reiterated this principle. *See Phipps v. FDIC*, 417 F.3d 1006,

1013 (8th Cir. 2005) (affirming the dismissal of an action claiming that late fees charged by the assignee of a national bank violated state usury laws).

In *Olvera v. Blitt & Gaines, PC*, 431 F.3d 285, 289 (7th Cir. 2005), plaintiffs brought an action alleging that purchasers of bad debts violated the Fair Debt Collection Practices Act by charging usurious interest under Illinois law – even though the loans were permissible under Illinois law when issued. The plaintiffs in that case argued that although the rates charged by the debt purchasers were "no higher (actually lower) than the original, lawful interest rates," the charges were usurious because the debt purchasers were not subject to the same interest rate exemptions as the originators. *Id.* The Seventh Circuit affirmed the dismissal of these claims, explaining that "once assignors were authorized to charge interest, the common law . . . gave the assignees the same right, because the common law puts the assignee in the assignor's shoes, whatever the shoe size." *Id.* at 289. It described the consequences of a contrary decision as "higher interest rates" for customers and a "credit market [that would] operate less efficiently," and concluded that, "even if the plaintiffs have a decent technical argument for their preferred interpretation, its unreasonable consequences weigh heavily against it." *Id.* at 288-89.

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In short, the *Madden* decision was wrong. As the OCC and the Department of Justice have explained to the Supreme Court:

> The court of appeals' decision [in *Madden*] is incorrect. Properly understood, a national bank's Section 85 authority to charge interest up to the maximum permitted by its home State encompasses the power to convey to an assignee the right to enforce the interest-rate term of the agreement.

Brief for the United States as Amicus Curiae 6, *Midland Funding, LLC v. Madden*, No. 15-610 (May 2016).

II. The *Madden* decision is causing confusion in the marketplace and hurting consumers.

Banks routinely transfer loans in order to serve consumers more effectively. Banks sell loans, or participation interest in loans, to investors, for example, which in turn is essential to banks' ability to extend mortgages or other credit to consumers. Likewise, banks assign loans to debt collectors in order to recover on delinquent debt – a function that is critical to maintaining banks' ability to extend affordable credit.

Madden fundamentally disrupted banks' reliance on loan assignment as a tool for financing and risk management, creating significant uncertainty in the credit markets. Lenders unsurprisingly have sought to reduce the risk that loans will become illegal upon assignment. Notably, "[s]ome lenders have decided to exclude the Second Circuit states (New York, Connecticut, and Vermont) from their marketing and lending programs." *See* Charles M. Horn & Melissa Hall, *The Curious Case of* Madden v. Midland Funding *and the Survival of the Valid-When-Made Doctrine*, 21 N.C. Banking Inst. 1, 22 (Mar. 2017). Likewise, in "securitization transactions, loans to borrowers in New York, Connecticut, and Vermont are sometimes excluded from the pools of loans to be purchased by the securitization vehicle." *Id.*

These predictable effects of the *Madden* decision have direct, negative consequences for consumers. A study found, for example, that the number of loans made in 2015 in New York and Connecticut by leading marketplace lending platforms dropped to 52% of 2014 levels. *See* Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & Econ. 673, 697 (2017). In contrast, the number of such loans increased by 124 percent in other circuits. *Id.* In other words, "lenders responded to the [*Madden*] decision by extending relatively less credit to borrowers in Connecticut and New York." *Id.* at 675. Thus, the researchers concluded: "First, our analysis of secondary-market trading shows that investors priced the additional risk created by *Madden* – particularly when the borrower underlying the note was late on payments. Second, we find that lenders limited credit availability in response to the decision." *Id.* at 702.

Madden has caused less credit to be available and the cost of credit to rise – and has harmed consumers in both respects. These are not academic matters. One study presented at the Federal Reserve Bank of Philadelphia, for example, has pointed to *Madden* as causing an 8% "increase in the incidence of personal bankruptcy" filings because of the "reduction in marketplace lending" that the decision caused. *See* Piotr Danisewicz & Ilof Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* (2018).[4] Consumers will be continue to be harmed as long as the *Madden* ruling remains in effect in the Second Circuit.

III. The OCC should issue a final rule that fixes the problems caused by the *Madden* decision.

[4] This study can be found at https://philadelphiafed.org/-/media/bank-resources/supervision-and-regulation/events/2018/fintech/resources/paper%202_piotr_financial_technology_and_bankruptcy.pdf?la=en.

We have urged Congress and the Supreme Court to step in and address the numerous problems caused by the *Madden* decision. Unfortunately, neither has done so, leaving credit markets unsettled and forcing consumers to bear the consequences. Moreover, the situation could worsen at any time if further courts follow the *Madden* decision and create additional regions in which national banks are deterred from – or practically unable to – extend credit. We thus welcome the Proposal and urge the OCC to proceed with this rulemaking.

We are grateful that the Proposal would fix the problems caused by the *Madden* decision by making clear that a loan that is valid when made does not become usurious once assigned or otherwise transferred. By doing so, the OCC would allow national banks to extend credit on a national basis once more, without having to worry about compliance with laws governing permissible interest in all fifty states.

We recognize that the Proposal makes clear that the OCC does not address questions relating to who is the "true lender when a bank makes a loan and assigns it to a third party." Proposal, 84 Fed. Reg. at 64232. While we do not address the merits of that decision here, we would emphasize that this limitation on the scope of the Proposal does not in any way undermine its rejection of the *Madden* decision. The "valid when made" rule and the "true lender" question are two independent issues. The OCC's decision not to address the latter in this rulemaking does not in any way undermine the effectiveness of its rejection of *Madden*.

Importantly, the OCC is clearly on sound legal footing as it pursues this rulemaking. The OCC has broad rulemaking authority to interpret the National Bank Act that encompasses the interpretation of Section 85. *See* 12 U.S.C. § 93a. *See also* 12 U.S.C. § 93(b)(12). The OCC is using that authority here to adopt a rule that had prevailed for almost two hundred years before *Madden* and that advances the statutory purpose of the National Bank Act. As discussed previously, the best reading of Section 85, consistent with longstanding practice and the purpose of that statute, is that a loan that is valid when made by a national bank does not become usurious upon assignment or other transfer. Indeed, this is the very interpretation that the OCC has previously adopted. *See, e.g.*, OCC, Interpretive Letter No. 115, 1979 WL 25434 (Aug. 10, 1979) ("[W]e have stated several times in correspondence that a fixed interest rate agreed upon at the inception of a loan remains valid throughout the term of the loan . . . .") (citing the Supreme Court's decision in *Nichols*, discussed above).

Moreover, even if a court were to conclude that the National Bank Act is ambiguous on this point, the OCC's rule undoubtedly reflects a reasonable interpretation of Section 85. As the Supreme Court has explained in the context of a

challenge to the OCC's interpretation of the National Bank Act, "if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *NationsBank of N. Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 257 (1995) (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)) (quotation marks and internal citations omitted). Where, as here, the OCC's reading of the statute "fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design," a reviewing court must give the OCC's judgment "controlling weight." *Id. See also Smiley v. Citibank (S. Dakota), N.A.*, 517 U.S. 735, 739 (1996) (applying *Chevron* deference to OCC interpretation of "interest" under Section 85). As a result, a final rule consistent with the Proposal would be entitled to deference by reviewing courts under the *Chevron* deference doctrine.

The OCC consequently should proceed with its rulemaking and issue a rule that fixes the problems caused by the *Madden* decision. In doing so, we would ask the OCC to work to ensure that its approach is consistent with that of the FDIC.[5]

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We thank you for your consideration of these comments and would be happy to discuss these issues further.

Sincerely,

Julie Stitzel

[5] *See* FDIC, Federal Interest Rate Authority, 84 Fed. Reg. 66845 (Dec. 6, 2019).