GEORGETOWN LAW

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January 5, 2020

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429
comments@fdic.gov

RE: RIN 3064—AF21

Dear Sir/Madam:

I write to strongly object to the Notice of Proposed Rulemaking (the "Proposed Rule") issued by the Federal Deposit Insurance Corporation (FDIC) regarding "Federal Interest Rate Authority," RIN 3064—AF21.[1] My comments on the Proposed Rule are restricted to proposed 12 C.F.R. § 331.4(e) (the "interest rate assignment provision"), regarding the legality of interest charged by non-bank assignees of state-chartered banks and insured branches of foreign banks (collectively, "State Banks"). I express no position here on the other provisions of the Proposed Rule.

In regard to the proposed interest rate assignment provision the FDIC, without claiming any statutory ambiguity, seeks to overturn the decision of the Second Circuit Court of Appeals in *Madden v. Midland Funding*,[2] to allow non-bank assignees of State Banks to charge interest at the greater of the rate permitted by the state in which the State Bank is located or the 90-day commercial paper rate,[3] without regard to the usury laws of the borrower's state. The Proposed Rule would thus effectively preempt state usury laws in order to allow non-bank assignees to purchase loans with interest rates that exceed the rates allowed if the non-bank assigned had made the loans themselves. The Proposed Rule would allow non-banks to do indirectly what they are forbidden to do directly, and in so doing endangers the safety-and-soundness of State banks and undermines consumer protections. As I detail

[1] 84 Fed. Reg. 66845 (Dec. 6, 2019).
[2] 786 F.3d 246 (2nd Cir. 2015).
[3] 12 U.S.C. § 1831d.

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below, this provision of the Proposed Rule is both illegal and bad policy. The FDIC should retract at least this portion of the Proposed Rule.

I. Qualifications

By way of background, I am the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center, where I teach courses in Consumer Finance, Financial Regulation, Contracts, Commercial Law, Structured Finance, and Bankruptcy. I have also previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School and as faculty for the Federal Trade Commission's Division of Financial Practices training program, and am elected member of the American Law Institute, which awarded me its Young Scholars Medal in 2013. I have also previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board and as an expert witness for the FDIC in a set of related rent-a-bank litigations.[4]

Among my publications is the first law school textbook on consumer finance, ADAM J. LEVITIN, *CONSUMER FINANCE: MARKETS AND REGULATION* (Wolters Kluwer 2018), which includes a chapter devoted to usury laws, as well as materials on rent-a-bank lending and securitization. I have also written several journalistic articles about the so-called "valid-when-made" doctrine, as well as submitted amicus briefs about the doctrine in four cases, including one in which the FDIC has also appeared as an amicus. The FDIC was served electronically (at its consent) with my amicus brief in that case. I have attached a copy of the brief, which details the spurious nature of the valid-when-made doctrine and the fallacious claim of the applicability of the common law of assignments to the question of what interest a non-bank may charge as an appendix.

II. The Proposed Rule Is Illegal

The interest rate assignment provision of Proposed Rule is illegal for two basic reasons. First, the FDIC is lacks statutory authority to undertake the rulemaking. The FDIC is authorized to undertake rulemakings only to carry out the provisions of the Federal Deposit Insurance Act, and the interest rate assignment provision is not carrying out a provision of the Federal Deposit Insurance Act. Even if it were, the FDIC is bound by the *Madden* decision under the Supreme Court's *Brand X* jurisprudence because section 27 of the Federal Deposit Insurance Act is unambiguous. Moreover, the FDIC's authority regarding interest rate assignment cannot exceed that of the Office of Comptroller of the Currency (OCC), and the provisions of the National Bank Act make clear that the OCC has no authority to undertake an interest rate assignment provision.

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[4] FDIC v. Columbus Bank & Trust, Columbus, Georgia, FDIC-08-139b, FDIC-08-140k (2008); FDIC v. First Bank of Delaware, Wilmington Delaware, FDIC-07-256b, FDIC-07-257k (2007); FDIC v. First Bank & Trust, Brookings, South Dakota, FDIC-07-228b, FDIC-07-260k (2007); FDIC v. CompuCredit Corp., FDIC-08-033b, FDIC-08-034k (2008).

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Second, the Proposed Rule is arbitrary and capricious and therefore in violation of the Administrative Procedures Act.[5] The Proposed Rule is arbitrary and capricious for four reasons: it lacks an evidentiary basis; it ignores key evidence; it patently misapplies common law; and its solution does not actually address key aspects of the supposed problem. This section elaborates on the legal problems with the interest rate assignment provision of the Proposed Rule.

A. *The Interest Rate Assignment Provision of the Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Goes Beyond the Scope of Congressional Delegation to the FDIC*

1. *The Interest Rate Assignment Provision of the Proposed Rule Goes Beyond the Scope of the FDIC's Statutory Authority Because the FDIC Has No Authority to Regulate Interest Charges by Non-banks*

The interest rate assignment provision of the Proposed Rule is illegal because it does not comply with the Administrative Procedures Act because it exceeds the scope of the FDIC's statutory authority.[6]

The key question the interest rate assignment provision addresses is whether the interest allowed to State Banks under section 27 of the Federal Deposit Insurance Act is affected by "sale, assignment, or other transfer of the loan," that is, whether the interest allowed under section 27 is permitted to a non-bank assignee. Congress has not delegated to the FDIC the power to preempt state usury laws with respect to non-banks. A rulemaking with this effect goes beyond the delegation to the FDIC in section 10(g) of the Federal Deposit Insurance Act.[7]

Section 10(g)(1) authorizes the FDIC to "prescribe regulations to carry out this chapter [the Federal Deposit Insurance Act]".[8] Yet the Proposed Rule never identifies any provision in the Federal Deposit Insurance Act that it is seeking to carry out regarding its proposal that the interest allowed to non-bank assignees of State Banks under section 27 not affected by "sale, assignment, or other transfer of the loan." Nor can it. The FDIC's definition is not seeking to effectuate any provision of the Federal Deposit Insurance Act. Instead, it is seeking to effectuate State Banks' power to assign loans, but that power does not arise under the Federal Deposit Insurance Act. Instead, it arises from state banking power statutes or state common law, not the Federal Deposit Insurance Act. Thus, the FDIC is in the preposterous position of claiming to preempt one type of state law (state usury laws) to effectuate another type of state law (state banking power laws). Absent a *federal* power, the FDIC simply lacks any authority to preempt state laws.

To the extent that the FDIC believes that the Proposed Rule is effectuating section 27, but it is incorrect. The delegation in section 10(g) is limited by the statutory text of section 27, which refers only to the power of "state banks." Section 27 does not authorize

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[5] 5 U.S.C. § 706(2)(A).
[6] 5 U.S.C. § 706(2)(C).
[7] 12 U.S.C. § 1820(g).
[8] *Id.* (emphasis added).

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entities other than state banks—be they national banks, uninsured foreign banks, credit unions, or other non-banks—to do anything. There is no ambiguity about what "state bank" means is section 27. The scope of the FDIC's interpretive authority under section 27 is limited to interest *for State Banks*.

Indeed, the limited authority in section 27 is clear from comparison with other statutory provisions in title 12. Congress has itself acted to preempt state usury laws with respect to non-banks in a specific context, namely in regard to first lien mortgage loans.[9] Moreover, that same provision expressly preempts state law even in the event of an assignment.[10] That provision was enacted as part of the same statute, the Depository Institution Deregulation and Monetary Control Act of 1980, that added section 27 to the Federal Deposit Insurance Act. That Congress has acted to preempt state usury laws for assignees other than State Banks in another context implies a lack of authority for the FDIC to act more broadly under section 27.

The Proposed Rule incorrectly states that "Denying an assignee the right to enforce a loan's terms would effectively prohibit assignment and render the power to make the loan at the rate provided by the statute illusory."[11] First, the *Madden* decision only affects a subset of potential assignees. All insured depositories are unaffected, and banks frequently buy each other's loans. Second, as the Second Circuit noted in *Madden*, denying the assignee the right to collect usurious interest would merely result in a lower sale price—the assignee would obtain the same rate of return through discounting the loans from face—and thereby avoid any problem with state usury laws. Third, the FDIC is conflating two distinct powers. The power to make loans at a particular interest rate—arising section 27—is separate and distinct from the power to assign them—a power from state banking power laws. The possibility of a lower resale price does not render the ability to make a loan at the rates authorized under section 27 illusory.

Likewise, while the Proposed Rule makes noise about the importance to bank safety-and-soundness of being able assign loans without regard for state usury laws,[12] but this is a rationale that is unmoored to any statutory text, and if accepted would be an impermissibly unlimited delegation. The FDIC simply lacks authority to undertake the Proposed Rule insofar as it deals with the legality of interest charged by non-bank assignees of State Banks.

[9] 12 U.S.C. § 1735f-7a.

[10] 12 U.S.C. § 1735f-7a(a)(1)(C)(v).

[11] 84 Fed. Reg. 66848 (Dec. 6, 2019).

[12] *See, e.g.,* 84 Fed. Reg. 66845 (Dec. 6, 2019). *See also* 84 Fed. Reg. 66848 (Dec. 6, 2019) ("restrictions on assignees' abilities to enforce interest rate terms would result in extremely distressed market values for many loans, frustrating the purpose of the FDI Act.").

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2. *The FDIC Is Bound by Madden v. Midland Funding, LLC and Has No Authority to Undertake the Interest Rate Assignment Provision of the Proposed Rulemaking*

The Proposed Rule seeks to overturn the result of the Second Circuit's ruling in *Madden v. Midland Funding, LLC*.[13] The FDIC does not appear to realize that it is in fact bound by the Second Circuit's interpretation of the National Bank Act in *Madden* absent any contrary judicial authority. It does not matter that the FDIC was not a party to Madden; the question is not one of issue preclusion, but one of *Chevron* jurisprudence. The FDIC has authority to interpret the Federal Deposit Insurance Act, but only to the extent that the statute is ambiguous. If the statute is unambiguous and the FDIC must defer to prior judicial authority, irrespective of whether it was party to such prior case.[14]

Thus in *United States v. Home Concrete & Supply, LLC*, the Supreme Court held that a Treasury regulation did not supplant a prior judicial interpretation of the statute because the statute was unambiguous.[15] Likewise, in *National Cable & Telecommunications Association v. Brand X Internet Services*, the Supreme Court held that "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[16]

Although the Supreme Court held that the statute in at issue in *Brand X* was ambiguous, the Circuit Court decision it reversed had applied a prior precedent against the challenged rulemaking even though the agency that promulgated the rule had not been a party to that prior litigation.[17] Subsequent Circuit Court opinions have made clear that when a statute is unambiguous, agencies are bound by prior judicial interpretation and that it is not necessary for the court to have expressly stated that the statute was unambiguous for the agency to be bound.[18]

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[13] 786 F.3d 246 (2nd Cir. 2015).

[14] The idea that the OCC should get any *Chevron* deference is further undermined by the fact that the OCC filed a brief with the Supreme Court opposing certiorari in *Madden*. While that brief did note that the OCC disagreed with *Madden*'s holding, it argued that the case was an inappropriate vehicle to address the case. In other words, the OCC had an opportunity to litigate the *Madden* case and declined to do so. The OCC cannot oppose certiorari because it believes that a case it an inappropriate vehicle for the courts to address a case and then decide that *it* is the appropriate entity to address an unambiguous statute. This sort of gamesmanship is beyond anything allowed by administrative law.

[15] 566 U.S. 478, 486-487 (2012).

[16] 545 U.S. 967, 982 (2005). I noted, however, that under section 25b of the National Bank Act, the Office of Comptroller of the Currency's rulemaking would not be entitled to *Chevron* deference. 12 U.S.C. § 25b.

[17] 545 U.S. 967 (2005).

[18] *See, e.g.*, Texas v. Alabama-Coushatta Tribe of Texas 918 F.3d 440 (5th Cir. 2019); Patel v. Napolitano, 706 F.3d 370 (4th Cir. 2013).

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In this instance, the Second Circuit ruled in *Madden* to interpret the unambiguous text of section 85 of the National Bank Act. Section 27 of the Federal Deposit Insurance Act is modeled on section 85 of the National Bank Act, such that the FDIC has itself argued that it is to be interpreted consistently with section 85.[19] The FDIC has not alleged any ambiguity about the statutory meaning of section 27; it has instead alleged there to be legal ambiguity for non-banks following *Madden*, but this sort of legal uncertainty is not the type of ambiguity that matters under *Brand X*. This means that the FDIC is bound under *Madden* regarding section 27 of the Federal Deposit Insurance Act, just as the OCC is bound regarding section 85 of the National Bank Act. The FDIC's policy preferences are irrelevant in this regard. Accordingly, the Proposed Rule goes beyond the scope of the Congressional delegation to the FDIC and is in violation of the Administrative Procedures Act.[20]

3. The FDIC's Authority Cannot Exceed that of the OCC, and the OCC lacks Authority to Regulate the Interest Rates that Non-Bank Assignees May Charge or Collect

As the FDIC recognizes, section 27 of the Federal Deposit Insurance Act must be read *in pari materia* with section 85 of the National Bank Act.[21] Thus, to the extent that section 85 does not authorize the OCC to regulate the interest rates that non-bank assignees of national banks may charge or collect, so too must the FDIC be limited in its authority to regulate the interest rates that non-bank assignees of State Banks may charge or collect.

I have separately submitted comments to the OCC regarding its proposed parallel rulemaking on interest rate assignment. My comments are attached to this submission. While I believe that the OCC lacks authority to undertake its proposed rule for a number of reasons, including some of the same as apply to the FDIC, there is one in particular that bears note here. Section 25b(b)-(c) of the National Bank Act makes clear that the OCC may not preempt state consumer financial protection laws unless it follows a particular procedure and meets a certain evidentiary threshold. While section 25b(f) of the National Bank Act cryptically preserves section 85, whatever section 25b(f) means, it does not provide that section 85 is exemption from the procedural requirements of section 25b.

More significantly for the purposes of the FDIC, Congress made clear in sections 25b(e) and 25b(h) of the National Bank Act that there is no preemption of state consumer financial protection laws for the affiliates, subsidiaries, and agents of national banks. It would be absurd for entities closely connected to national banks not to be able to shelter in section 85 of the National Bank Act, but for all manner of non-bank, including the affiliates, subsidiaries, and agents of State Banks to be able to shelter in section 27 of the Federal Deposit Insurance Act. National banks are "national favorites," such that their treatment is always equal to or better than that of State Banks.[22] Sections 25b(e) and 25b(h) of the

[19] 84 Fed. Reg. 66846-47, 66849 (Dec. 6, 2019) ("While *Madden* interpreted section 85, rather than the FDI Act, section 27 is patterned after section 85 and receives the same interpretation as section 85.").

[20] 5 U.S.C. § 706(2)(C).

[21] 84 Fed. Reg. 66846-47, 66849 (Dec. 6, 2019).

[22] Tiffany v. Nat'l Bank of Mo., 85 U.S. 409, 412-13 (1874).

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National Bank Act indicate the limitation on the OCC's authority, which in turn indicates the limitation on the FDIC's authority.

B. *The Interest Rate Assignment Provision of the Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Is Arbitrary and Capricious*

1. *The Interest Rate Assignment Provision of the Proposed Rule Is Arbitrary and Capricious Because It Lacks Any Evidentiary Basis*

On top of the FDIC's lack of authority for the rulemaking, the Proposed Rule fails to comply with the Administrative Procedures Act because it is arbitrary and capricious because it lacks an evidentiary basis.[23] The Proposed Rule claims that it is necessary to protect State Banks' ability to sell loans without any evidentiary basis of this in fact being a problem post-*Madden*. The FDIC has adduced no evidence that State Banks' in fact have difficulty selling loans post-*Madden*.

The FDIC concedes that it does not have the information regarding the number of small entities that have been directly affected by ambiguity resulting from *Madden*.[24] Just as the FDIC lacks this information on small banks, so too does it lack it on banks generally because the FDIC does not collect the relevant information from any banks. Indeed, the FDIC presents no data whatsoever on the frequency or scale of bank loan sales to non-banks or on the circumstances in which they occur, much less on the number of loans potentially affected by the *Madden* decision. The Proposed Rule cannot stand on naked assertions about the importance of asset sales to bank liquidity generally and on the further implicit assumption that banks rely on sales of loans with interest rates exceeding state usury caps as an important source of liquidity. There is no evidentiary basis whatsoever for either assertion. Accordingly, the rule is arbitrary and capricious.

More generally, the FDIC has presented no evidence that the sale of debt obligations with interest rates that exceed state usury caps is a material source of liquidity for any bank, much less for banks in general. Banks obtain liquidity primarily through the incurrence of liabilities—accepting deposits—and through borrowing via repurchase agreements (repos), correspondent bank lines, Federal Home Loan Bank advances, and the Federal Reserve's discount window. Banks do not generally rely on the sale of non-mortgage assets as a key liquidity source.

Similarly, the FDIC asserts that "The market for loan sales and securitization is a lower-cost source of funding for State banks, and the proposed rule would support State banks' access to this market."[25] No evidence whatsoever is presented that the market for loan

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[23] 5 U.S.C. § 706(2)(A).

[24] 84 Fed. Reg. 66851 (Dec. 6, 2019). FDIC likewise concedes that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected." *Id.*

[25] 84 Fed. Reg. 66851 (Dec. 6, 2019).

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sales and securitization is a lower-cost source of funding? Indeed, it is not even clear from the assertion what the point of comparison is. Loan sales and securitization are a "lower-cost source of funding" than what? Surely the FDIC is not asserting that it is lower cost than banks' primary source of funding—deposits—or than interbank borrowing at the Federal Funds rate.

The closest the FDIC comes to adducing any evidence is to quote a banking industry analyst's unproven claim about *Madden* creating uncertainty in the minds of unspecified market participants.[26] A rulemaking cannot stand on such bald speculation any more than it can stand on naked assertions about the importance of asset sales to bank liquidity, without a showing that State Banks materially rely on the sale of that subset of loans with interest rates exceeding state usury caps for liquidity.

2. The Interest Rate Assignment Provision of the Proposed Rule Is Arbitrary and Capricious Because It Ignores Key Contrary Evidence

Not only does the interest rate assignment provision of the Proposed Rule lack an evidentiary basis, but it entirely ignores some of the most obvious and contrary evidence. Accordingly, it is arbitrary and capricious and therefore in violation of the Administrative Procedures Act.[27]

While the Proposed Rule contends that it is necessary to protect bank liquidity, the idea that state usury laws actually constrain bank liquidity is preposterous. Banks may always sell loans to other banks. There are over 5,200 federally insured depositories, so there is a robust market for State bank loans simply from other State Banks and national banks, none of which are subject to state usury laws. Nowhere in the Proposed Rule is this enormous market for bank loans ever mentioned.

Additionally, the Proposed Rule ignores that state usury laws do not actually prevent the sale of bank loans to non-banks, even if the loans have interest rates that exceed state usury caps. The loan purchaser may always choose to forgo collecting interest that exceeds the state usury cap. If the purchaser does so, it is likely to discount what it will pay on the purchase price. As the Second Circuit noted in *Madden*, the fact that the sale price of the loans may be lower than otherwise is not a significant interference with banking powers. The Federal Deposit Insurance Act is not a retail price maintenance statute. There is a world of difference between ensuring that there is a market for bank loans and insisting that banks get the best possible price for their loans.

Because the Proposed rule ignores obvious contrary evidence—failing to give it any consideration whatsoever—it is arbitrary and capricious.

3. The Interest Rate Assignment Provision of the Proposed Rule Is Arbitrary and Capricious Because It Is Based on a Patent Misapplication of the Common Law

The FDIC claims that interest rate assignment provision of the Proposed Rule is based on the principles found in the common law of assignments and is consistent with the so-

[26] 84 Fed. Reg. 66850 (Dec. 6, 2019).
[27] 5 U.S.C. § 706(2)(A).

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called "valid-when-made" doctrine.[28] This is incorrect on both counts. Neither the common law of assignments or the actual valid-when-made doctrine supports the Proposed Rule. A rule that is founded on a patent misrepresentation of the law is arbitrary and capricious and "otherwise not in accordance with law" and therefore violates the Administrative Procedures Act.[29]

a. The Proposed Rule Misapplies the Common Law of Contracts

The FDIC contends that interest rate assignment provision of the Proposed Rule is consistent with the common law of contract assignment, which generally allows an assignee to accede to all of the rights of the assignor under the contract.[30] While this is an accurate characterization of the law of contracts, it is a misapplication of the common law of contracts to the question of whether a State Bank's interest rate exportation power under section 27 of the Federal Deposit Insurance Act is assignable.

The common law of assignments relates solely to the assignment of rights under a contract or property rights. It has no bearing on whether federal statutory status or privileges may be assigned. A State Bank's power to export interest rates is a function of statute, not contract. Most favored lender status cannot arise from contract because contract cannot displace state usury statutes and other state regulations. Because essence a personal privilege, not a property right it is no more assignable than a medical license or a tax-exempt status or FDIC insurance or Federal Reserve System discount window access. If these privileges were freely assignable there would be no point in having a licensing regime like state bank chartering and FDIC insurance because regulators would not exercise control over who ultimately gained the privileges attached to the license. Accordingly, the common law of assignments has nothing whatsoever to do with the assignability of most favored lender status.[31]

b. The Proposed Rule Misapplies the So-Called "Valid-When-Made" Doctrine

The FDIC also claims that the Proposed Rule is consistent with the so-called "valid-when-made" doctrine.[32] The FDIC claims that this doctrine means that if a loan was valid when it was made for purposes of state usury law, it cannot thereafter cease to be valid by virtue of an assignment. The FDIC's claim is founded on a blatant misreading of historical cases. There has never been a valid-when-made doctrine such as the one the FDIC claims. Instead, to the extent that any sort of valid-when made doctrine exists, it is about the

[28] 84 Fed. Reg. 66848 (Dec. 6, 2019).

[29] 5 U.S.C. § 706(2)(A).

[30] *Id.*

[31] The Seventh Circuit simply erred in this regard in *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005). In any event, the Seventh Circuit was sitting in diversity jurisdiction and its pronouncements on state common law of contracts law are not controlling.

[32] 84 Fed. Reg. 66848 (Dec. 6, 2019).

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calculation of the interest rate on a loan, not about what law determines the applicable usury rate.

In support of the Proposed Rule, the FDIC cites a pair of 19th century Supreme Court decisions, *Nichols v. Fearson*[33] and *Gaither v. Farmers & Mechs. Bank of Georgetown*,[34] as standing for a "cardinal rule[] in the doctrine of usury," namely that "if a loan is non-usurious at origination, the loan does not subsequently become usurious when assigned."[35] That is a blatant mischaracterization of these decisions. The Supreme Court held in both cases that the interest imputed from a discounted sale of a loan would not be added to the stated interest rate on the loan for the purpose of calculating whether *the assignor* violated state usury law. The cases had absolutely nothing to do with what interest rate the *assignee* could charge.

I have written at length previously about the ahistoricity of the valid-when-made doctrine as claimed by the FDIC. In particular, I refer the FDIC to an amicus brief I filed in a federal district court cased captioned *Rent-Rite Super Kegs West Ltd. v. World Business Lenders,* LLC, 1:19-cv-01552- REB (D.Colo.). FDIC also appeared as an amicus in this on-going litigation, and my brief was served on the FDIC electronically per the FDIC's consent. I have attached the brief as an appendix to these comments. It shows that the historical cases relied up for a "valid-when-made" doctrine have absolutely nothing to do with the ability of a non-bank assignees of a bank to shelter in the bank's ability to export interest rates under section 85. Instead, to the extent that such a doctrine has ever existed, it deals with three distinct issues related to the calculation of the interest rate, not the question of what usury law applied. I note here that in its amicus brief in the *Rent-Rite* litigation the FDIC engaged in more extensive selective and even misleading quotation from other cases, not one of which actually supports its position in the Proposed Rule.

Putting aside the doctrinal fabrication, the FDIC claims that a rule consistent with "valid-when-made" is necessary to have a "workable rule" to determine the timing of compliance with section 27. This is nonsense. The *Madden* Rule provides an elegantly workable and administrable rule for determining the timing of compliance with section 27: section 27 does not apply to non-banks, so they never need to concern themselves with it, while it always applies to banks, so they do not need to worry about compliance with state usury laws.

4. *The Interest Rate Assignment Provision of the Proposed Rule Is Arbitrary and Capricious Because Its Solution Fails to Address an Important Aspect of the Problem*

Finally, the Proposed Rule is arbitrary and capricious and therefore violates the Administrative Procedures Act because its solution entirely fails to address an important aspect of the problem of market uncertainty regarding interest rate assignment—the "true

[33] 32 U.S. (7 Pet.) 103, 109 (1833).
[34] 26 U.S. (1 Pet.) 37, 43 (1828).
[35] 84 Fed. Reg. 66848 (Dec. 6, 2019).

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lender" doctrine.[36] The FDIC notes the problem of uncertainty after the *Madden* decision, but the truth is that the uncertainty about what interest rate a non-bank assignee of a State Bank may charge did not begin with *Madden* in 2015. Instead, it began in 2004 with the inclusion of a "true lender" provision in the Georgia Payday Loan Act,[37] and subsequent litigation.[38] Since 2004, several courts have adopted a similar "true lender" doctrine as a matter of state common law,[39] and such a provision is also consistent with 19th and early 20th century federal common law to disregard sham transactions for usury purposes.[40]

True lender doctrine and the question of whether a non-bank assignee may shelter in section 27 are inextricably intertwined. The Proposed Rule explicitly states that it does not take a position on true lender issues.[41] Without addressing true lender doctrine, the rule fails to materially reduce any uncertainty about what interest rate is permissible on a loan assigned by a State Bank. As such, the proposed rule is arbitrary and capricious and therefore illegal under the Administrative Procedures Act because its solution does not address a key aspect of the problem it identifies.

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[36] *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 43 (1983) (noting that an agency rule is "arbitrary and capricious" if the rule "entirely failed to consider an important aspect of the problem"); *see also* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971) (holding that, in assessing whether a rule is arbitrary and capricious, "the ultimate standard of review is a narrow one").

[37] OCGA § 16-17-1(c).

[38] Ga. Cash Am. v. Greene, 318 Ga. App. 355, 361-362 (Ga. Ct. App. 2012).

[39] Easter v. Am. West Fin., 381 F.3d 948, 957-959 (9th Cir. 2004) (applying true lender doctrine under Washington State law); Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012) (noting that, "where a plaintiff has alleged that a national bank is the lender in name only, courts have generally looked to the real nature of the loan to determine whether a non-bank entity is the de facto lender"); CashCall, Inc. v. Morrisey, 2014 W. Va. LEXIS 587, at* 43 2014 WL 2404300, at *14 (W.Va. May 30, 2014) (looking to form, not substance under West Virginia law); Pennsylvania v. Think Fin., Inc., 2016 U.S. Dist. LEXIS 4649, *30-33, 2016 WL 161597 (E.D. Pa. Jan. 14, 2016, upholding complaint based on true lender doctrine under Pennsylvania law); Consumer Fin. Prot. Bureau v. CashCall, Inc., 2016 U.S. Dist. LEXIS 130584, *15-16 (C.D. Cal. 2016) (form, not substance determines who is the true lender); Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134, 1150-1151 (D. Colo. 2018) (declining to dismiss a complaint predicated on true lender doctrine under Colorado law); Meade v. Marlette Funding LLC, 2018 U.S. Dist. LEXIS 46814, *8-9, 2018 WL 1417706 (D. Colo. Mar. 21, 2018) (same); CashCall, Inc. v. Md. Comm'r of Fin. Regulation, 448 Md. 412, 436, 139 A.3d 990, 1005, 2016 Md. LEXIS 371, *36 (Md. Ct. App. 2016) (holding a party that was the de facto lender was a "credit services business" subject to Maryland usury law).

[40] Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

[41] *See* 84 Fed. Reg. 66846 (Dec. 6, 2019).

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III. The Proposed Rule Is Bad Policy

The Proposed Rule is non-mandatory and it should be retracted because it is bad policy. The Proposed Rule is contrary to the FDIC's duties to ensure the safety and soundness of State Banks and consumer protection from predatory lending.

A. The Proposed Rule Does Not Actually Enhance State Banks' Liquidity

The FDIC claims that the Proposed Rule helps protect and enhance State Banks' liquidity and risk management.[42] This is incorrect. The Proposed Rule does not materially enhance State Banks' liquidity or risk management capabilities, and the FDIC has adduced no evidence that it does. This is because a State Bank can already always sell loans—no matter the interest rate—to any of the more than 5,200 other State Banks and national banks in the United States. A potential market of over 5,200 buyers subject to the same or higher usury caps is not a constrained market, nor does the FDIC present any evidence that it is. The claim that limiting the market for usurious loans to over 5,200 banks impairs bank risk management is unsupported and frankly preposterous.

Moreover, State Banks can already always sell loans—no matter the interest rate—to any non-bank. *Madden* did not change this situation by one iota. The only catch is that because under *Madden* the non-bank cannot collect the usurious interest, it will discount the purchase price, but there is a difference between preserving liquidity and maintaining resale prices. The Second Circuit found in *Madden* that this would not be a "significant interference" with a national bank power.

The FDIC's Proposed Rule stands on an even thinner statutory basis than the OCC's parallel rulemaking because there is no federal banking power at issue for State Banks, whose powers (other than regarding interest rates under section 27 of the Federal Deposit Insurance Act) come from state law, not federal law, and FDIC has not claimed otherwise in the Proposed Rule.

Additionally, as noted above, the Proposed Rule presents no evidence that most banks in fact rely on the loan sale market to non-banks for liquidity. Only the very largest banks engage in securitization of any assets other than residential mortgage loans. While banks will sell charged off loans to non-bank debt buyers, this is not a material source of liquidity for banks, and only a few State Banks currently engage in rent-a-bank transactions. Instead, banks' primary sources of liquidity are deposits and wholesale funding markets, as well as Federal Home Loan Bank advances, and the GSE cash windows, with the Federal Reserve's discount window as a backup. To suggest that *Madden* has materially threatened State Bank liquidity is preposterous and unsupported by any evidence.

Moreover, if uncertainty about what usury cap applies to a non-bank assignee is the problem, the FDIC's Proposed Rule presents no solution, as discussed above, because it does not remove the uncertainty that comes from true lender doctrine.

B. The Proposed Rule Facilitates Rent-a-Bank Arrangements That Pose Pipeline and Reputational Risk for State Banks

[42] 84 Fed. Reg. 66845 (Dec. 6, 2019).

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Rather than provide a material enhancement of bank liquidity, the Proposed Rule merely facilitates rent-a-bank lending arrangements, by which I mean arrangements where a bank agrees in advance to make loans according to a non-bank's specifications and to transfer a substantial economic interest in those loans to the non-bank (or its affiliate). Rent-a-bank arrangements are an inherent threat to the safety-and-soundness of State Banks because of the pipeline and reputational risks involved. If the non-bank fails to honor its commitment to purchase the economic interest in the loans, the State Bank will be stuck with the risk of a bunch of loans that by definition it would never have made for its own account. Moreover, because the sole reason for non-banks to engage in rent-a-bank lending is the evasion of state usury laws, there is reputational risk for State Banks because they will be associated with predatory lending, which may hurt their other lines of business.

C. The Proposed Rule Facilitates Predatory Lending and Is Contrary to the FDIC's Consumer Protection Mandate

Because the Proposed Rule facilitates rent-a-bank lending arrangements, it undermines state consumer protection laws. Rent-a-bank lending enables non-banks to make loans indirectly that they are forbidden to make directly. Whatever the FDIC may think of the wisdom of state usury laws and state laws restricting various types of loan fees, these laws are on the books and apply to non-banks, and it is not the FDIC's place to second-guess them or attempt to undermine them. The CFPB has brought enforcement actions for unfair and deceptive and abusive acts and practices for rent-a-tribe lending relationships. The FDIC, which enforces the same statute, should similarly discourage, rather than facilitate analogous rent-a-bank relationships. Indeed, historically the FDIC has done precisely that; I served as an expert witness for the FDIC in litigation in brought against a set of State Banks that engaged in a rent-a-bank relationship with CompuCredit, an early subprime "fintech" non-bank lender.

Incredibly, the FDIC argues in the Proposed Rule that "in the absence of the proposed rule, [consumers unable to obtain credit through marketplace lenders engaged in rent-a-bank relationships] might be unable to obtain credit from State banks and might instead borrow at higher interest rates from less-regulated lenders."[43] The absurdity of this statement is astonishing. The only effect the FDIC has been able to identify from the *Madden* decision was on marketplace lending. The whole nature of marketplace lending is that it is done through rent-a-bank arrangements in states with lower usury caps. In such arrangements, the loans are for all material purposes made by the less-regulated non-bank lenders. Indeed, this is true with rent-a-bank arrangements generally. The fact that rent-a-bank lenders do not use banks in states with higher usury caps shows that banks' involvement in the loans is just window dressing for the purpose of evading usury laws.

Instead of protecting consumers from "higher interest rates from less-regulated lenders," the Proposed Rule would effectively legalize exactly those lending relationships, as long as State Banks get paid a cut. The FDIC's stated concern about consumers ending up with loans from "higher interest rates from less-regulated lenders" is impossible to square with the Proposed Rule, which lacks any limitation on assignments undertaken for the

[43] 84 Fed. Reg. 66850 (Dec. 6, 2019).

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purpose of evading state usury laws and thus greenlights rent-a-bank lending by unregulated, high-cost lenders.

D. The Proposed Rule Would Create a Regulatory Vacuum

State Banks are allowed the privilege of interest rate exportation under section 27. That privilege, however, comes with being subject to a comprehensive federal regulatory regime, including regular federal examination by the FDIC or CFPB for compliance with consumer financial laws. Non-bank assignees of State Banks are not subject to such a regulatory regime. Unless they fall into certain enumerated types of institutions,[44] they are not subject to any sort of federal supervisory authority for compliance with consumer financial laws. Indeed, non-bank assignees of State Banks may not even be subject to *state* supervision, as they need not be state-licensed. For example, a State Bank might assign loans to an off-shore special purpose entity, such as a Cayman Islands trust, which would be entirely outside the scope of any US regulatory authority.[45]

Congress has allowed State Banks the privilege of interest rate exportation because it is confident that the FDIC's careful regulatory stewardship of State Banks will be an adequate substitute for any particular state's usury laws. Allowing unregulated non-banks to take advantage of State Banks' interest rate exportation undermines that trade-off and creates a regulatory vacuum in which there is no meaningful consumer protection.[46]

E. The Proposed Rule Fails to Exclude Assignments Undertaken to Evade State Usury Laws

There are some loan sale transactions, such as securitizations, that do not raise inherent consumer protection consumers, even if they do not currently comply with state usury laws. But the Proposed Rule fails to differentiate between benign transactions and malignant ones. In particular, it fails to exclude transactions undertaken to evade state usury laws, even though the anti-evasion principle is core to usury jurisprudence.[47] Indeed, the FDIC notes that it takes no position on "true lender" doctrine, which is one mode of analyzing whether a transaction is undertaken to evade state usury laws.[48]

Remarkably, the FDIC notes that it "supports the position that it will view unfavorably entities that partner with a State bank with the sole goal of evading a lower

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[44] 12 U.S.C. §§ 1867, 5514.

[45] Elevate Financial, a fintech that has rent-a-bank relationships with two insured state banks, uses a Cayman Islands special purpose vehicle to purchase loan participations from those banks. *See* Kadhim Shubber, *Why this subprime lender funds loans through the Cayman Islands*, FIN. TIMES, Jan. 29, 2016, https://ftalphaville.ft.com/2016/01/19/2150488/why-this-texas-subprime-lender-routes-loans-through-the-cayman-islands/.

[46] Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 143, 176 (2009).

[47] *See e.g.*, Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

[48] *See* 84 Fed. Reg. 66846 (Dec. 6, 2019).

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interest rate established under the law of the entity's licensing State(s)."[49] Sadly, the FDIC's statement here is not credible.[50] First, without taking a position on true lender doctrine, it is difficult to implement any sort of anti-evasion policy position.

Second, the FDIC has long permitted a number of State Banks, including Republic Bank and Trust Company of Kentucky, FinWise Bank of Utah, and Bank of Lake Mills, Wisconsin, to rent out their charters to non-banks lenders for no purpose other than facilitation of the non-banks' evasion of state usury laws. That this is the sole reason for the banks' involvement in the transactions is clear from the fact that the non-banks do not partner with banks in states where their products do not face binding usury caps. Either the FDIC is unaware of the activities of its regulatory charges—despite media coverage thereof[51]—or the FDIC is blowing smoke. While the FDIC may claim to view these transactions "unfavorably," the FDIC's amicus brief in the *Rent-Rite Super Kegs West Ltd.* litigation in support of a rent-a-bank and its lack of action to shut down these rent-a-banks telegraph's a very different policy position.

I strongly urge the FDIC, if it persists in this ill-advised rulemaking, to include a provision that clearly excludes rent-a-bank arrangements and other assignments undertaken for the primary purpose of evading state usury laws. Doing so would not only be consistent with the FDIC's consumer protection mandate—for Congress has not yet generally preempted state usury laws, even for national banks, only allowed rate exportation—but also because it is the only position that is consistent with well-established Supreme Court precedent.

Conclusion

The interest rate assignment provision of the Proposed Rule, proposed 12 C.F.R. § 331.4(e), is illegal and misguided. I urge the FDIC to abandon this provision of the Proposed Rule and get back to its job of ensuring consumers protection and the safety-and-soundness of State Banks. The FDIC should not mistake the protection of profits at the handful of bad actor banks that engage in rent-a-bank arrangements with its job of husbanding the State

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[49] *Id.*

[50] I also note the strange oblique phrasing—"the FDIC supports the position"—whose position? Is this not the FDIC's own position?

[51] *See, e.g.*, Grace Schneider, *'Rent-a-bank' scheme? Louisville bank accused of helping companies evade interest rate limits*, LOUISVILLE COURIER JOURNAL, Nov. 21, 2019, https://www.courier-journal.com/story/news/local/2019/11/20/republic-bank-louisville-bashed-over-lending-deal-elevate/4232537002/; David Dayen, *Trump's Bank Regulators Open the Door to More Predatory Lending*, AM. PROSPECT, Nov. 19, 2019, https://prospect.org/power/trump%E2%80%99s-bank-regulators-open-the-door-to-more-predatory-lend/.

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Banking industry for the benefit of American consumers.[52] The FDIC should retract the interest rate assignment provision of the Proposed Rule.

Sincerely,

[redacted]

Adam J. Levitin

Attachments:

(1) Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).
(2) Adam J. Levitin, *'Madden fix' bills are a recipe for predatory lending*, Am. Banker, Aug. 28, 2017, https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending.
(3) Adam J. Levitin, Comment Letter to the Office of Comptroller of the Currency Re: Docket No. OCC-2019-0027 (RIN 1557-AE73), January 5, 2020.

[52] As Sir Thomas More notes in Richard Bolt's *A Man for All Seasons*, "For Wales? Why Richard, it profit a man nothing to give his soul for the whole world. . . but for Wales!" So too, the FDIC is giving its soul for a handful of bad actor rent-a-banks.

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<u>ATTACHMENT 1</u>

Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant,

Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC,

No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).

IN THE UNITED STATES DISTRICT COURT DISTRICT OF COLORADO RENT-RITE SUPER KEGS WEST, LTD., Appellant, v. WORLD BUSINESS LENDERS, LLC Appellee.	▲ **COURT USE ONLY** ▲
Adam J. Levitin Agnes N. Williams Research Professor & Professor of Law Georgetown University Law Center 600 New Jersey Ave., NW Hotung 6022 Washington, DC 20001 (202) 662-9234 adam.levitin@law.georgetown.edu	Case No. 1:19-cv-01552-REB (Appeal from Bankruptcy Adversary Proceeding No. 18-1099-TBM)

MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT

DATED: September 19, 2019

[redacted]

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Professor Adam J. Levitin, *pro se*, respectfully requests leave to submit the attached, conditionally filed, *amicus curiae* brief in support of the Appellant, Rent-Rite Super Kegs West, Ltd., and as grounds therefore states the following:

INTRODUCTION

On its face, the instant litigation is an unremarkable adversary proceeding in a small business bankruptcy, the ultimate outcome of which has no particular public policy significance. Yet this is no ordinary *business* bankruptcy appeal. This case involves the single most critical *consumer* credit regulation issue in the courts today—the vitality of a so-called "valid-when-made" doctrine, which purports to hold that a non-bank lender may ignore state usury laws for loans it purchases from a bank that is exempt from those laws.

If courts recognize a "valid-when-made" doctrine, high-cost non-bank lenders, such as payday lenders and predatory small business lenders, will be able to evade long-standing state interest rate limits[1] through "rent-a-bank" lending

[1] States have set interest rate limits since the founding of our nation. *See* AMERICANS FOR FAIRNESS IN LENDING, THE HISTORY OF USURY (citing *James M.*

schemes, in which a non-bank lender uses a complicit bank to originate loans, which are promptly sold to the non-bank lender. Payday lenders have long attempted to use rent-a-bank schemes, which regulators have historically shut down,[2] but these attempts are making a comeback. Colorado, in particular, has been active in attempting to prevent a new wave of rent-a-bank lending, and two high-profile cases bought by the Colorado Attorney General are pending. *See Meade, Uniform Consumer Credit Code Administrator v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); *Meade, Uniform Consumer Credit Code Administrator v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).[3]

The unusual involvement of the Federal Deposit Insurance Corporation ("FDIC") and Office of the Comptroller of the Currency ("OCC") as *amici* in the appeal of an otherwise unexceptional small business bankruptcy adversary

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Ackerman, Interest Rates and the Law: A History of Usury, 1981 ARIZ. ST. L.J. 61 (1981)), https://bit.ly/2lSASjl.

[2] *See* NATIONAL CONSUMER LAW CENTER, CONSUMER CREDIT REGULATION § 9.6.1 (2D ED. 2015), *updated at* www.nclc.org/library; *see also ID.* §§ 3.4.3.3, 3.4.3a.

[3] Professor Levitin has previously submitted amicus briefs on the valid-when-made doctrine in both of these cases.

proceeding underscores the importance of the consumer credit policy issue implicated in this case. The FDIC and OCC allege that a purported "valid-when-made doctrine" is a longstanding, "cardinal rule" of banking law and incorporated into the federal statutes preempting state usury laws for bank. Yet the doctrine appears only in a handful of recent cases. With one exception, it cannot be found in caselaw predating the relevant statute, much less in treatises, or scholarly articles, and the Second Circuit rejected the doctrine in 2015 in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

After the defendant in the *Madden* case unsuccessfully sought *certiorari* from the Supreme Court of the United States, 136 S. Ct. 2505 (2016), the financial services industry attempted to advance "*Madden*-fix" legislation in Congress. *See* H.R. 3299 (115th Cong.); S. 1642 (115th Cong.). Numerous state attorneys generals, led by the Colorado Attorney General,[4] and over 200 consumer, civil rights, faith

[4] *See* Letter from Cynthia H. Coffman, Attorney General of Colorado, *et al*. to Hon. Mitch McConnell *et al.,* opposing H.R. 3299 and S. 1642 (June 27, 2018), https://bit.ly/2kCyjlp.

and other groups[5] voiced their opposition to the legislation, and Congress did not act to overturn the decision.

The OCC and FDIC are now intervening as *amici* in an obscure small business bankruptcy dispute to seek a favorable appellate decision on the valid-when-made doctrine that could ultimately produce a circuit split. Such a circuit split might entice the Supreme Court to grant *certiorari* and possibly overturn the Second Circuit's *Madden* decision. Simply put, this is a critical case for consumer credit policy.

In this amicus brief, Professor Levitin draws on his expertise in the history of negotiable instruments and usury regulation to address the spurious pedigree of the valid-when-made doctrine, which is a recent invention, rather than a fundamental part of American banking and negotiable instrument law.

INTEREST OF AMICUS CURIAE

Amicus curiae Adam Levitin is the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center in Washington, D.C. Professor Levitin's scholarship and teaching focuses on consumer finance regulation

[5] See letter from 202 state and national groups opposing H.R. 3299 (McHenry) and S. 1642 (Warner) (Nov. 29, 2017), https://bit.ly/2kNossK.

and commercial law, including the law of usury and the law of negotiable instruments. He has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board, as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP).

Professor Levitin has previously written about the origins of the "valid-when-made" doctrine and the effects of preemption of state consumer protection laws in rent-a-bank transactions. *See* Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, AMERICAN BANKER, Aug. 28, 2017 (valid-when-made doctrine); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 145 (2009) (rent-a-bank transactions). He has also previously testified before Congress thirty times, including at a hearing specifically addressing the valid-when-made doctrine. Hearing Before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, Jan. 30, 2018 (testimony of Professor Adam J. Levitin). Professor Levitin has also previously filed amicus briefs on the valid-when-made doctrine in Colorado state court litigation brought by the Colorado Uniform Consumer Credit

Code Administrator against non-banks engaged in rent-a-bank transactions. Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade, Uniform Consumer Credit Code Administrator v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade, Uniform Consumer Credit Code Administrator v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).

Professor Levitin believes that his expertise regarding the history of usury regulation in the United States will be helpful to the court, particularly in light of the claims of Appellee and its amici that the "valid-when-made" doctrine is a longstanding, fundamental rule of US banking law.

DESIRABILITY OF AMICUS CURIAE BRIEF

As explained above, this case has potentially momentous implications for states' ability to regulate consumer lending by non-banks. Given the importance of the alleged historicity of the valid-when-made doctrine for its applicability through incorporation in the Depository Institutions Deregulation and Monetary Control Act of 1980, an informed understanding of its supposed caselaw roots is critical for the Court's evaluation. This is where Professor Levitin seeks to assist the Court.

The 18th century English and early 19th century American commercial law cases on which the "valid-when-made" doctrine claims to rest are extraordinarily difficult for modern readers to parse. These cases involve a set of financial instruments, transactions, doctrinal problems, procedural stances, and even terminology that have largely disappeared from commerce. Further obfuscating the meaning of these cases is the style of judicial writing. These are cases that only a commercial law professor with antiquarian inclinations could love. Professor Levitin believes that his familiarity with these cases, with historical negotiable instrument law, and as well as with the larger (and now obscure) doctrinal context of usury law in the 19th century would assist the court in evaluating the claims about the historicity of the "valid-when-made" doctrine and whether it is in fact part of the background to the Depository Institutions Deregulation and Monetary Control Act of 1980.

POSITION OF THE PARTIES

Professor Levitin has obtained the consent of the Appellant to the filing of an amicus brief. Professor Levitin has not received any response from Appellee in regard to his request for consent to file.

TIMELINESS OF THE AMICUS BRIEF

Professor Levitin recognizes that he is seeking to file the amicus brief after the ordinary deadline provided by Federal Rule of Bankruptcy Procedure 8017(a)(6). Rule 8017(a)(6) provides the district court with discretion to grant leave for later filing. *See also Wildearth Guardians v. Lane*, 2012 WL 10028647 (D.N.M. 2012) (noting federal courts' broad discretion to allow participation of an amicus and the lack of 10th Circuit precedent).

Professor Levitin requests leave for a late-filing of the amicus brief on the grounds that he was not aware of the litigation until the Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency filed their amicus brief in support of the Appellee on September 10, 2019.

As noted above, this case is of potentially significant importance for consumer credit regulation because of its implication for the "valid-when-made" doctrine. Yet because the doctrinal question arose in a small business bankruptcy case, it received no notice within the community of consumer credit scholars or consumer advocates, who had no reason to be aware of this particular case among the thousands being litigated in the federal courts. It is also unusual for the FDIC or OCC to file an amicus brief before a district court. The unusual context of the case is the reason that Professor Levitin was unaware of the case and thus unable to file a timely amicus brief. Upon learning of the case, Professor Levitin promptly prepared the conditionally filed brief and submitted this motion.

Additionally, upon learning of the case, Professor Levitin spoke with leadership at a number of national consumer advocacy groups, as well as with the offices of certain state banking regulators and attorneys general. All confirmed that this case had escaped the notice of all of them—including the Colorado Attorney General's office—because it arose in the context of an unexceptional small business bankruptcy. All were concerned at the possibility of a district court upholding a "valid-when-made" theory, but none believed that they would be able to respond quickly enough with their own late-filed amicus briefs, in part because of their own internal institutional processes for approving amicus filings.

Given the importance of the case to consumer credit regulatory policy and the absence of institutional amici to offset the presence of the FDIC and OCC, Professor Levitin believes that the assistance of an academic amicus in support of the Appellant, even in a late-filed brief, is important to ensure a fully briefed consideration of by the Court of the historicity of the "valid-when-made" doctrine.

WHEREFORE, Professor Levitin respectfully requests leave to file the brief submitted with this motion.

Respectfully submitted this 19th day of September 2018.

[redacted]

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by email upon the following this 19th day of September, 2019:

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I further certify that a true and correct copy of the foregoing MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by Federal Express delivery upon the following, this 19th day of September, 2019:

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Professor Adam J. Levitin

IN THE UNITED STATES DISTRICT COURT DISTRICT OF COLORADO RENT-RITE SUPER KEGS WEST, LTD., Appellant, v. WORLD BUSINESS LENDERS, LLC Appellee.	▲ **COURT USE ONLY** ▲
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AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT

DATED: September 19, 2019

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Pleadings and Opinion Below

Statutes and Regulations

Cases

Legislative Materials

Miscellaneous Authorities

INTRODUCTION

On its face, the instant litigation is an unremarkable adversary proceeding in a small business's bankruptcy, the ultimate outcome of which has no particular public policy significance. Yet this is no ordinary bankruptcy appeal. Although this is a *business* bankruptcy case, it involves the most critical *consumer* credit regulation issue in the courts today—the vitality of a so-called "valid-when-made" doctrine. That doctrine purports to hold that a non-bank lender may ignore state usury laws for loans it purchases from a bank that is exempt from those laws.

The vitality of a "valid-when-made" doctrine is a question of whether federal preemption of state usury laws for banks under the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") or under the National Bank Act of 1864 ("NBA") is assignable to non-bank lenders that are not covered by those statutes. That is, is federal preemption a feature of a loan that travels with it like a warranty, or is it a non-transferrable privilege, personal to the federally-regulated bank? Thus, when a bank that is not subject to a state's usury law by virtue of federal preemption assigns a loan to a non-bank, may the non-bank also shelter in federal preemption despite not being subject to the federal bank regulation regime?

The stakes are significant for consumer credit regulation. Since colonial times, states have had usury laws to protect their citizens. While a wave of deregulation starting in 1978 exempted banks from state usury laws, states retain authority over non-bank lenders. If courts recognize a "valid-when-made" doctrine, high-cost non-bank lenders, such as payday lenders and predatory small business lenders, will be able to evade state usury laws through "rent-a-bank" lending schemes, in which a non-bank lender uses a complicit bank to originate loans, which are promptly sold to the non-bank lender. As a court recently observed:

> If [the statute] indeed gave [assignees] a preemption defense for any loan that originated with a federal savings bank, then homeowners would be deprived of state law protections based solely on their original lender and [assignees] would be allowed to engag[e] in the otherwise illegal conduct.

McShannock v. JP Morgan Chase Bank, N.A., 354 F.Supp.3d 1063, 1077 (N.D. Cal. 2018) (internal quotations omitted) (holding that preemption under the Home Owners Loan Act of 1933 was not assignable). Payday lenders have long attempted to use rent-a-bank schemes, which regulators have historically shut down,[1] but these attempts are making a comeback.

In this case, the record is not developed, but there are indicia of rent-a-bank lending as a Colorado small business obtained a 120% interest rate loan from a tiny

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[1] *SEE* NAT'L CONSUMER L. CTR., CONSUMER CREDIT REGULATION § 9.6.1 (2d ed. 2015), *updated at* www.nclc.org/library; *see also ID.* §§ 3.4.3.3, 3.4.3a.

Wisconsin community bank that then transferred the loan to Appellee, World Business Lenders, LLC ("Appellee"), a subprime small business lending specialist firm based in New Jersey. *See* Zeke Faux, *Wall Street Finds New Subprime With 125% Business Loans*, BLOOMBERG.COM, May 22, 2014, *at* http://www.bloomberg.com/news/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans.html (discussing Appellee's predatory business practices) (included as Appendix A).

INTEREST OF AMICUS

Amicus curiae Adam Levitin is the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center. Professor Levitin's scholarship focuses on consumer finance regulation and commercial law, including the law of usury and the law of negotiable instruments. He has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board and as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School.

Professor Levitin has previously written about the origins of the "valid-when-made" doctrine and the effects of preemption of state consumer protection laws in rent-a-bank transactions. *See* Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, AMERICAN BANKER, Aug. 28, 2017 (valid-when-made doctrine); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets*

Upstream, 26 YALE J. ON REG. 145 (2009) (rent-a-bank transactions). He has also testified before Congress regarding the "valid-when-made" doctrine. Hearing Before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, Jan. 30, 2018. Professor Levitin has also filed amicus briefs on the "valid-when-made" doctrine in litigation brought by the Colorado Attorney General against non-banks engaged in rent-a-bank transactions. Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).

Professor Levitin's interest in this litigation is in ensuring a proper understanding of usury laws and their relationship to the so-called "valid-when-made" doctrine. Professor Levitin takes no position on other issues in this litigation.

Professor Levitin has authored and funded this brief entirely himself. He has no financial stake in the litigation.

ARGUMENT

The Bankruptcy Court held that "the long-established 'valid-when-made' rule answers the question" of:

> whether a promissory note originated by a state bank with a non-usurious interest rate under DIDA section 1831 somehow can be transformed into a usurious promissory note by virtue of assignment to a non-bank entity.

Op. at 21. Likewise, Appellee and its *Amici*, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (together "*Amici*"), point to this "longstanding" doctrine as a basis for affirming the bankruptcy court. Appellee's Br. at 1-2; Amici Br. at 3. *Amici* refer to the "valid-when-made" doctrine as a "well-established and widely-accepted rule," Amici Br. at 10, and claim that the Supreme Court described it as a "'cardinal rule' of American law." *Id.* Moreover, according to the Bankruptcy Court, the valid-when-made doctrine's "long-accepted principles were inherently incorporated into the NBA and, later, the DIDA." Op. at 21.

Yet if the law were in fact so "well-settled" on this point, as *Amici* claim, it begs the question why two federal bank regulators would bother filing a joint amicus brief in the district court in a small business bankruptcy appeal to which no regulated bank is a party? The presence of the *Amici* underscores that the law is hardly well-settled—and indeed, the Second Circuit has rejected the valid-when-made argument, *Madden v. Midland Funding, LLC*, 786 F.3d 246, 250-53 (2d Cir. 2015) (holding that National Bank Act preemption does not apply to a debt buyer from a national bank)—but that they would like it to be.

Appellee and *Amici* present three arguments in support of the valid-when-made principle. First, they argue that DIDA preemption is assignable under the common law of contracts. Second, they claim that "valid-when-made" is a "longstanding" doctrine and "well-settled" law that was part of the common law background to the NBA and DIDA (which is modeled on the NBA) and thus incorporated in those statutes. Therefore, Appellee and *Amici* argue, a non-bank purchaser of a loan originated by a bank also purchases DIDA preemption of state usury laws. Third, they argue that irrespective of the historical roots of valid-when-made, the principle is inherent within DIDA section 1831d, 12 U.S.C. § 1831d.

All three of these arguments are wrong. DIDA preemption is not a contract right that can be freely assigned. It is not alienable property, but is a privilege personal to a bank that comes as part of a bundle of a detailed regulatory scheme.

Likewise, the supposed historical roots of "valid-when-made" are spurious. With one exception, nothing approaching the claimed "valid-when-made" doctrine is to be found in cases, treatises, or scholarly articles that pre-date DIDA's 1980 preemption provision, much less the 1864 NBA, such that this supposedly longstanding doctrine is not even mentioned by name prior to 2015, when it suddenly appeared as part of unsuccessful *amicus curiae* briefing by financial institution trade associations in support of the defendant debt buyer in the *Madden* litigation.

No pre-1864 case deals with a "valid-when-made" situation, and only a single pre-1980 case cited by *Amici* deals with a transactional situation even remotely similar to the "valid-when-made" issue. *Amici* rely entirely and improperly on out-of-context and even misleadingly edited quotations from older cases to support the doctrine's claimed antiquity. At best the doctrine is "valid-when-made-up," and even the handful of post-1980 cases consistent with the doctrine are readily distinguishable from the instant litigation and some also include an exception for loans intended for assignment *ab initio*.

Similarly, there is nothing in DIDA section 1831d that compels "valid-when-made." The power of banks to assign their loans does not inherently include the power to assign federal preemption to non-bank entities. Contrary to *Amici*'s hyperbolic claims, declining to create a "valid-when-made" doctrine (with a falsified historical pedigree) will not prevent banks from selling loans in the secondary market. Instead, as the Second Circuit rightly recognized in *Madden v. Midland Funding, LLC*, 786 F.3d at 251, applying state usury laws to non-bank assignees will merely reduce the price at which banks are able to sell a subset of usurious loans.

Whether a "valid-when-made" doctrine *should* exist is a policy question properly reserved for the legislature, not the courts, and bills seeking to enact have failed to advance in Congress.

A. The Common Law of Assignments Is Irrelevant Because DIDA Preemption Is Not an Assignable Right Under a Contract

Amici argue that under the common law of contracts, the assignee takes all of the rights of the assignor. Amici Br. at 14-16. That is true, subject to an important limitation: an assignee takes all of the rights of the assignor *under the contract. See* Restatement (2d) of the Law, Contracts, § 317(2) ("A *contractual* right can be assigned….") (emphasis added). It is self-evident that an assignee does not assume the assignor's other rights extraneous to the contract, such as rights under licenses or from status. For example, if I sell my car, the buyer gets whatever rights are appurtenant to the car, but does not also get my driver's license or the benefits of my American Automobile Association membership , much less my parental or spousal rights.

This limitation underscores *Amici's* misconceptualization of what DIDA preemption is. Preemption is not a right *under the contract* that can be assigned. It is not an alienable property right or a characteristic of the loan that travels with the note. Instead, DIDA preemption is a personal and non-transferrable privilege that is part of a legal scheme that applies only to banks. Indeed, DIDA preemption does not void state usury laws—state usury laws remains valid and in effect for nondepositories. Instead, DIDA preemption merely allows an insured depository to export the usury cap of its home state into other states. DIDA preemption is part of a bundle of regulatory benefits and burdens specific to banks; allowing it to be assigned to a non-bank would result in a regulatory vacuum in which the non-bank would be exempt from state law, but also not subject to federal regulation. *See Levitin, Hydraulic Regulation*, *supra* at 188-89.

B. "Valid-When-Made" Is Not Incorporated in the NBA or DIDA Because It Is a Modern Invention Lacking Historical Roots

1. "Valid-When-Made" Responds to a Problem That Could Not Exist Prior to the NBA

Amici argue that "valid-when-made" is incorporate in DIDA because it was part of the common law background to section 85 of the NBA, 12 U.S.C. § 85, on which DIDA section 1831d is patterned. *See* Amici Br. at 5-6. Collectively, the Bankruptcy Court, the Appellee, and especially *Amici* cite to numerous cases that pre-date DIDA's enactment in 1980 and also to five cases that pre-date the NBA's enactment in 1864. Significantly, neither the Bankruptcy Court opinion, nor the briefing by the Appellee or *Amici* actually discusses the context or substance of a single pre-DIDA opinion. Instead, in every instance, they rely on selective snippets of decontextualized and even edited language that supposedly establishes "valid-when-made" as a "cardinal rule" of banking law. When one examines the actual cases, however, it becomes apparent that nothing remotely approaching a "valid-when-made" doctrine existed prior to DIDA, much less the NBA.

As an initial matter, the doctrine could not possibly have existed prior to the enactment of the NBA in 1864 because there was no situation in which it could have arisen. Prior to the NBA, state usury laws applied to all entities equally, with choice of law rules limited by an anti-evasion principle. *Miller v. Tiffany*, 68 U.S. 298, 308 (1864). Therefore, it was not possible prior to 1864 for a loan to be non-usurious in the hands of a bank, yet be usurious in the hands of a non-bank assignee merely by virtue of an assignment. This means that all of the *ante-bellum* cases on which the Appellee and *Amici* rely have nothing to do with the issue in this case. Accordingly, the "valid-when-made" doctrine could not be background law against which the NBA was enacted, and thus it could not have been incorporated into DIDA.

2. The Bankruptcy Court, Appellee, and Amici Rely on Decontextualized Language from Pre-DIDA Cases that Have No Connection to "Valid-When-Made"

An examination of the pre-DIDA cases cited by the Bankruptcy Court, Appellee, and *Amici* shows that with one exception, *Strike v. Trans-West Discount Corp.*, 92 Cal.App.3d 735, 745 (Cal. Ct. App. 4th Dist. 1979), none of them are dealing with anything remotely related to "valid-when-made" in the sense of assignment of a loan from a bank to a non-bank having no impact on the application of usury laws. *Strike* was decided as a matter of the California Constitution and expressly carves out an exception for loans intended to be assigned *ab initio*, as may well be the case in this litigation. *Id.* (citing *Calimpco, Inc. v. Warden*, 100 Cal. App. 2d 429, 446-447 (Cal. Ct. App. 1st Dist. 1950) ("If [an assignee cannot be held liable for accepting usurious interest], the statutes on usury might as well be abolished. All a lender would have to do would be to obtain a contract from a borrower providing for usurious interests…and then assign his contract and the contract would no longer be usurious.")). *See also Miller v. Tiffany*, 68 U.S. at 308 (contractual choice of law provisions for usury are enforceable, but when done with intent to evade the law, law of the contract location applies).

It is hardly support for "valid-when-made" being part of the pre-DIDA, much less pre-NBA, common law.

Other than *Strike*, the pre-DIDA cases address three issue patterns:

(1) the effect of the exercise of a payment option by the borrower on the usurious status of a loan (*i.e.*, where there is no assignment of the loan involved);

(2) the effect of a discounted assignment, where the question is whether the discount in the assignment may be treated as imputed interest on the note; or

(3) the effect of a valid assignment on a usurious loan (*i.e.*, the inverse transaction from that at issue).

Thus, the evidence Appellee and *Amici* adduce of the historical roots of the doctrine is limited to a set of selective, decontextualized, and even misleading quotations from cases that have nothing to do with the doctrine as they describe it. The doctrine's historical pedigree is thus entirely invented by shoehorning selective and decontextualized quotations from older cases to serve a modern deregulatory policy agenda. Indeed, even the handful of post-DIDA cases that are consistent with the doctrine are almost all pyramided on a single decision's selective and out-of-context language from a 19th century Supreme Court case.

a. Cases Regarding Effect of Debtor's Payment Option

Many of the cases cited in support of "valid-when-made" fit the "option" pattern.[2] Sometimes the option in these cases is prepayment, sometimes it is late

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[2] *See Tate* v. *Wellings*, 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J.), (effect on usury calculation of loan of stock that was repayable in stock or cash at the borrower's option); *Unity Plan Finance Co. v. Green*, 155 So. 900, 905 (La. 1934) (effect on the calculation of the interest rate on the acceleration of the debt upon the debtor's failure to timely pay); *State v. J. C. Penney Co.*, 179 N.W.2d 641, 645 (Wis.

payment, and sometimes it is the form of payment. These cases generally do not even involve assignments of the loan. In all these cases, the idea that the calculation of the interest rate on a loan for usury purposes should not be determined based on the debtor's exercise of an option has nothing to do with "valid-when-made" in the sense of whether an assignment of the loan affects what state's usury law applies to the creditor.

1970) (language cited by *Amici* is actually from a block quotation from *Zang v. Schumann*, 262 Wis. 570, 577-579 (Wisc. 1952) (effect of borrower exercising option to pay extra premium to be relieved from a lease)); *First Nat'l Bank v. Danek*, 556 P.2d 31, 34 (N.M. 1976) (whether value of a non-optional discounted stock sale accompanying the loan should be included in the interest for the loan); *FDIC v. Tito Castro Constr.*, 548 F. Supp. 1224, 1227 (D.P.R. 1982) ("it was only as a consequence of defendant's election to delay in repaying the principal amount of those [demand] notes that an effective rate of interest in excess of the Puerto Rico statutory ceiling may have resulted."); *Rangen, Inc. v. Valley Trout Farms, Inc.*, 658 P.2d 955, 959 (Id. 1983) (effect on usury calculation of a fee for late payment option); *Saul v. Midlantic Nat'l Bank*, 572 A.2d 650, 658 (N.J. App. Div. 1990) (effect on usury calculation borrower's optional prepayments).

Unfortunately, in an attempt to pressgang inapposite precedent for support from option cases, *Amici* engage in misleading edits of quotations. For example, *Amici* represent *Hoffman v. Key Federal Sav. and Loan Ass'n*, 416 A.2d 1265, 1269 (Md. 1979) as standing for:

> "[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious" by subsequent acts.

Amici Br.at 12-13. But what *Hoffman* actually says is that:

> "[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious ***by voluntary prepayment***."

416 A.2d 1265, 1269 (emphasis added).

Similarly, *Amici* cite *Southwest Concrete Products. v. Gosh Construction Corp.*, 51 Cal.3d 701, 708 (1990) for the proposition that:

> "a transaction that was not usurious at its inception cannot become usurious by virtue of" a later act.

Amici Br.at 13, n.9. The full quotation from *Southwest Concrete Products,* however is that:

> "a transaction that was not usurious at its inception cannot become usurious by virtue of **the debtor's voluntary default.**"

Southwest Concrete Prods. v. Gosh Construction Corp., 51 Cal.3d 701, 708 (Cal. 1990) (emphasis added). Rather than expressing support for the idea that an assignment of a loan has no effect on what state's usury law applies, *Hoffman* and

Southwest Concrete Products merely state that the debtor's exercise of a payment option does not affect the rate on the loan for usury calculations. *Amici*'s editing and paraphrasing of the quotations, however, misleadingly portrays these cases as supporting "valid-when-made."

b. Cases Regarding the Effect of Usury in a Second, Subsequent Transaction on the First Transaction

The second common fact pattern in the cases relied upon for support of "valid-when-made" is the question of whether when there were two transactions, usury in transaction #2 could be imputed to transaction #1. As with the option cases, the issue here has nothing to do with the question of what jurisdiction's usury law applies to the note, but merely about whether rate on the note exceeds the usury cap.

Several of the cases cited in support of "valid-when-made" deal with the two-transaction scenario, particularly the impact of discounting of notes and bills. To understand these cases, it is important to recognize that in the 19th century a robust secondary market in bill and notes, which were frequently sold at a discount from their face amount The discount from face can be conceived as interest because the obligor on the note would owe the face amount irrespective of the discount to the purchaser. For example, if a $120 note were purchased for $100, the purchaser would have a right to collect the full face amount of $120. Economically, however, the transaction is equivalent to the purchaser having made a $100 loan and received $20 in interest. Indeed, this concept is still regularly applied today in the tax and bankruptcy law, where "original issue discount" on bonds is treated as imputed interest. *See, e.g.*, Treas. Reg. § 1.61-7(c); *In re Chateaugay Corp.*, 961 F.2d 378 (2d Cir. 1992); *Matter of Pengo Indus. Inc.*, 962 F.2d 543 (5th Cir. 1992).

Critically, the discounted sale issue does not give rise to the evasion of state usury laws like the "valid-when-made" doctrine. When a note is sold with a discounted sale, the borrower continues to pay interest to the purchaser at the contract rate, which would have been legal had the purchaser made the loan itself. The usury question only arises from the imputed interest in the discount. "Valid-when-made" deals with a situation in which the loan would have been illegal had the assignee made it directly. The "valid-when-made" would allow non-bank lenders to do indirectly what they cannot do directly.

Thus, *Amici* cite *Tuttle v. Clark*, 4 Conn. 153 (1822), which involved whether a discounted sale of a note would be treated as a sale or a loan. 4 Conn. at 156 (reporter's description). *Tuttle*'s holding—that the note "not being usurious in its original concoction, did not become so, by the subsequent [discounted] sale to the plaintiffs", 4 Conn. at 157—has nothing to do with the question of whether a non-bank may piggyback on the unique exemption of banks from state usury laws. The case is wholly inapposite for the proposition for which *Amici* cite it.

Similarly, *Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. (1 Pet.) 37 (1828) involved a non-usurious note that was pledged by the payee as collateral for an unrelated, usurious loan. 26 U.S. (1 Pet.) at 41. The Supreme Court observed that:

> [T]he rule cannot be doubted, that if the note free from usury, in its origin, no *subsequent* <u>*usurious*</u> *transactions respecting it*, can affect it with the taint of usury.

Id. at 43 (emphasis added). The point here is that usury in transaction #2 does not impute usury to unconnected transaction #1. *Gaither* had nothing to do with the supposed "valid-when-made" doctrine that a "promissory note originated by a state bank with a non-usurious interest rate under DIDA section 1831" cannot "be transformed into a usurious promissory note by virtue of assignment to a non-bank entity". Op. at 21. Again, as in *Tuttle,* the interest charged on transaction #1 continued to be charged at a rate that would have been legal had the assignee made the loan directly, whereas the current case involves a loan that would have been illegal for the assignee to make directly.

Likewise, *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103 (1833), involved a discounted sale of a note indorsed by the defendant. 32 U.S. at 103. When the defendant indorsed the note, the defendant became jointly liable for the full face amount of the note, just as if it were the maker of the note. *See* UCC § 3-415(a). The Supreme Court held that the usurious discounting did not void the original note, *id.* at 110, 112, observing that among the:

> cardinal rules of the doctrine of usury …[is] that a contract which in its inception is unaffected by usury can never be invalidated by any *subsequent usurious transaction*.

Id. at 109 (emphasis added). *See also id.* at 106 ("the rule of law is everywhere acknowledged that a contract free from usury in its inception shall not be invalidated by any *subsequent usurious transactions upon it*.") (emphasis added). Again, the point is that usury in transaction #2 does not affect transaction #1. *Nichols* has nothing to do with the present question of whether a bank can transfer its statutory preemption privilege to an assignee to allow the assignee to purchase and enforce a loan that the assignee could not legally make itself.

The same pattern appears in a more recent case, *Concord Realty v. Cont'l Funding*, 776 P.2d 1114, 1120 (Colo. 1989), which addressed whether the interest rate should be calculated based on the contract rate or on the imputed rate of interest from a foreclosure sale bid. The language quote by the *Amici,* "the usurious nature of a transaction must be determined from its inception" merely refers to the timing of the calculation of the interest rate, not the question of what law applies, which is the issue in this case.

c. Cases Regarding the Effect of a Subsequent Valid Transaction on Prior Usury

The third common fact pattern in the cases relied upon for support of "valid-when-made" is the about the effect of a later valid transaction on a loan that is usurious *ab initio. See Highway Equip. & Supply Co. v. Jones*, 153 N.W.2d 859, 863 (Neb. 1967) (issue of whether initial usury was purged by assignment); *Coral Gables First Nat. Bank v. Constructors of Fla., Inc.*, 119 So. 2d 741, 746 (Fla. Dist. Ct. App. 1960) (effect of renewal of a usurious loan on non-usurious terms); *Waggener v. Holt Chew Motor Co.*, 274 P.2d 968, 971 (Colo. 1954) (lender's acquisition of required license after making loan at rate above that allowed for unlicensed lenders does not cure violation).

Also in this pattern is *Watkins v. Taylor*, 16 Va. 424, 436 (Va. 1811) (effect of payment by surety on surety's subrogation claim on usurious contract). Shockingly, *Amici* fail to note that the language they quote from *Watkins* is from the *dissent*, not the majority opinion. Given that the subrogated surety was ultimately subject to the usury defense, *Watkins* tells us nothing about the existence of a "valid-when-made" doctrine, but again shows *Amici* playing fast-and-loose in their presentation of the law.

2. The "Valid-When-Made" Doctrine Is Entirely Absent from Historical Usury and Banking Law Treatises

If the "valid-when-made" doctrine were a "cardinal rule" of banking law, founded on Supreme Court opinions, one would expect it to regularly appear in 19th and 20th century usury and banking law treatises. Yet the doctrine is entirely unknown to historical treatise writers. Nothing even approaching the "valid-when-made" doctrine in which the assignment of a loan from an originator to an assignee subject to a different state usury law appears in any 19th or 20th century usury treatise. No prior reference to "valid-when-made" can be found in *any* banking or usury treatise.

Amici cite to language from 1838 edition of Blackstone's Commentaries on the Laws of England for support: "'[t]he usury must be part of the contract in its inception' for a contract to be deemed usurious." Amici Br. at 10. The quoted language is not from Blackstone himself, but from an annotator's footnote. It too, however, does not support the "valid-when-made" doctrine. The footnote cites two English cases, *Lowes v. Mazzaredo*, 1 Stark 385 (Assizes at Nisi Prius 1816) (usurious discounting of a non-usurious bill of exchange—pattern #2), and *Lowe v.*

Waller, 2 Dougl. 736 (King's Bench 1781) (good faith assignee of a usurious bill of exchange is subject to the defense of usury—pattern #3 of loan usurious *ab initio*), both of which are uninformative about the "valid-when-made" doctrine.

Similarly, *Amici* cite the 2018 edition of the *American Jurisprudence (2d)* treatise on Interest and Usury. Amici Br. at 10 (citing 44B Am. Jur. 2d Interest and Usury § 65 (2018)). That treatise too also never refers to "valid-when-made" and note one of the cases it cites in support of the language quoted by *Amici*—that the "usurious nature of a transaction is [determined] at the inception of the transaction" and that "usury therefore must exist at the inception of the contract"—deals with the question of whether an assignment affects the usurious status of a loan. The cases cited by *American Jurisprudence (2d)* are all in either payment option cases (the first pattern) or usury in separate, subsequent transactions (the second pattern).

3. Only a Single Pre-DIDA Case That Supports "Valid-When-Made"

There is only one pre-DIDA decision that is consistent with a "valid-when-made" doctrine. *Strike v. Trans-West Discount Corp.*, 92 Cal.App.3d at 745 (Cal. Ct. App. 4th Dist. 1979). The presence of a single pre-DIDA decision embracing valid-when-made suggests that it is unlikely that the doctrine is incorporated in DIDA.

Strike, notably, does not mention any such doctrine, even though *Strike* dealt with a situation similar to the instant case—a loan was assigned from a bank (exempt from California usury law by the California constitution) to a non-bank that was normally subject to California usury law. The California Court of Appeals held that the transfer of the loan did not change its status vis-à-vis the usury laws, but suggested that the outcome would be different if the loan had been intended for assignment *ab initio*. *Id.* This is a sensible position that ensures the liquidity of bank loans, but also prevents abuse of federal preemption through rent-a-bank arrangements and the like. *Strike* is the only pre-DIDA case that fits with "valid-when-made," and there is no evidence that Congress intended to incorporate its rule into DIDA, but if *Strike* was incorporated, that incorporation would also include the exception for loans intended for assignment *ab initio*.

4. Post-DIDA Cases All Stand on a Misreading of Nichols v. Fearson

A handful of post-1980 cases arguably support the doctrine, although they were obviously not incorporated into DIDA because they post-date the statute. These post-1980 cases are in a line founded on a misinterpretation of the same decontextualized quotation from *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103 (1833), upon which the Bankruptcy Court opinion, Appellee, and *Amici* rely. Thus, *Munoz v. Pipestone Financial, LLC*, 513 F.Supp.2d 1076 (D. Minn. 2007) cites to *Phipps* *v. FDIC*, 417 F.3d 1006 (8th Cir. 2005), which in turn relies with no original analysis on *Krispin v. May Dep't Stores Co*., 218 F.3d 919 (8th Cir. 2000), which in turn relies on *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148-49, n.17 (5th Cir. 1981). An examination of *Lattimore Land Corp.* and *Krispin* show that neither is applicable to the instant case.

The holding in *Lattimore Land Corp.* was supported by two citations with no original analysis. One citation was to *Nichols v. Fearson* and the other to *Huntsman v. Longwell*, 4 F.2d 105 (5th Cir. 1925). *Huntsman*, unlike *Lattimore*, was not an assignment case, and properly relied *Nichols* as support for the idea that imputed interest from transaction #2 cannot be bundled with interest from transaction #1 to result in a combined interest rate that violates the usury cap. 4.F.2d at 106.

Lattimore, however, misread *Hunstman* and *Nichols* (as did subsequent courts, including the Bankruptcy Court in this case). These courts take the Jovian language from *Nichols* that among the "cardinal rules" of usury is that:

> a contract which in its inception is unaffected by usury can never be invalidated by any subsequent usurious transaction

32 U.S. at 109, and omit the penultimate word, so that it reads:

> a contract which in its inception is unaffected by usury can never be invalidated by any subsequent … transaction.

Indeed, *Huntsman* itself, in paraphrasing *Nichols* omitted the penultimate word. 4 F.2d at 106. By ignoring the word "usurious," courts have misread *Nichols* as standing for a broader proposition than it does. *Nichols* is a holding about the effect of a usurious discounting, nothing more. Hence the Supreme Court referred to "any subsequent ***usurious*** transaction," not merely "any subsequent transaction." The entire line of modern "valid-when-made" cases all stands on this misreading of *Nichols*.[3]

There is only one pre-DIDA decision, *Strike,*92 Cal.App.3d. at 745 (Cal. Ct. App. 4th Dist. 1979), that is consistent with a "valid-when-made" doctrine. The presence of a single pre-DIDA decision embracing "valid-when-made" makes it unlikely that the doctrine is incorporated in DIDA, but if *Strike* was incorporated,

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[3] *Krispin v. May Dep't Stores* can also be distinguished from the instant case because it involved a transfer between a bank and its parent corporation (a department store), not a transfer between two unaffiliated parties. The continued affiliation between the bank and the debt buyer and the bank's continued involvement in the loan was the key factor in *Krispin.* 218 F.3d at 924. No such corporate nexus exists in this case.

that incorporation would also include its exception for loans intended for assignment *ab initio*.

Because the "valid-when-made" doctrine did not exist at the time of DIDA's enactment, it could not have been incorporated in DIDA, and the doctrine's current vitality is far from a "well-settled" matter, as it was rejected by the Second Circuit in 2015. *Madden*, 786 F.3d at 250-53.

C. "Valid When Made" Is Not an Inherent Implication of DIDA section 1831d

Amici further argue that irrespective of historical roots, "valid-when-made" is an inherent implication of section 1831d of DIDA. Amici Br. at 16-20. No one questions the power of banks to assign their loans. But it does not follow that the authority to assign loans also means the authority to assign federal preemption to non-bank entities that are not subject to the same extensive regulatory scheme as banks with the effect of also immunizing the non-banks from state laws. It is absurd to suggest that an inherent implication of section 1831d—part of a *federal bank* regulation law—is that *non-banks* should be exempt from *state* regulation.

Amici contend, however, that absent "valid-when-made" it would be "uneconomic" and "disastrous in terms of bank operations" because banks could not sell loans in the secondary market. Amici Br. at 17. Similarly, the Bankruptcy Court claimed that "[a]ny contrary legal standard would interfere with the proper functioning of state banks". Op. at 22.

There is no evidence in the record to support the Bankruptcy Court's conclusion, which is a matter of supposition about financial markets that goes beyond the proper scope of any judicial notice. In any event, this hyperbolic conjecture is demonstrably wrong; the ability of banks to sell loans in the secondary market does not depend on the vitality of "valid-when-made." Nothing in the *Madden* position prevents banks from selling loans.

First, the principal secondary market in the United States is the market for mortgages. State usury laws are preempted for most mortgages, regardless of the entity that holds them. 12 U.S.C. §§ 1735f-7, 1735f-7a. Indeed, the broad express preemption for mortgages suggests that Congress did not intend such broad preemption for other types of loans.

Second, there are over 5,300 FDIC insured banks, all of which benefit from DIDA preemption. FDIC Statistics on Depository Institutions, 2d Quarter 2019. Even without a "valid-when-made" doctrine, there is a sizeable potential secondary market for non-mortgage loans that is unaffected by state usury laws.

Third, most bank loans are made at non-usurious rates—nothing like the 120.86% rate in this case. "Valid-when-made" is not necessary for a secondary market in non-usurious loans, and indeed, non-banks regularly sell their non-usurious loans without incident.

Fourth, even usurious loans can still be sold absent "valid-when-made" because usury laws are not self-executing and are unlikely to be invoked absent a default on the loan. A robust "grey" market exists in "stale" debts, which are unenforceable because they are beyond the statute of limitations. *See, e.g.*, Andrew Martin, *Old Debts That Won't Die,* N.Y. TIMES, July 30, 2010, at B1. There is no reason to believe that a "grey" market would not also persist in usurious debts without "valid-when-made."

The only consequence of rejecting the spurious "valid-when-made" doctrine would be to decrease the price at which bank could sell *usurious* loans. DIDA, however, is not a price guaranty for banks' sale of usurious loans. As the Second Circuit observed in *Madden*, application of state usury laws to the assignee of a national bank might "decrease the amount a national bank could charge for its consumer debt in certain states," but that possible outcome would not "significantly interfere with the exercise of a national bank power." 786 F.3d at 251. So too, a lower price for usurious loans would not be a significant impairment of banks' powers, much less a conflict with section 1831d of DIDA, particularly in light of presumption against preemption in areas of traditional state regulation, such as consumer protection law. *Vien-Phuong Thi Ho v. Recontrust Co., NA*, 840 F.3d 618, 625 (9th Cir. 2016).

D. The Court Should Clearly State that It Is Not Addressing Whether Appellee Was the "True Lender" or Whether the *Ab Initio* Exception to "Valid-When-Made" Is Applicable

There are three doctrinal paths by which Appellee could be subject to Colorado's usury law. First, Appellee could be liable if the Court follows *Madden* and holds that DIDA preemption does not immunize non-bank assignees of banks. Second, the Appellee could be liable if it is found to be the "true lender" on the loan, meaning that the involvement of Lake Mills Bank in the loan was so *de minimis* that it should be disregarded. And third, Appellee could be liable if the Court holds that it falls under the exception to "valid-when-made" for loans intended for assignment *ab initio. See Strike,* 92 Cal.App.3d at 745; *Lattimore*, 656 F.2d at 148 n.15.

Only the first of these three paths has been briefed in this appeal and has a factual record sufficient for judgment. It is important that the Court not rule more broadly than necessary in this case. Irrespective of the outcome, the Court should make clear that it is not addressing the two paths to liability that are not before it. In particular, the Court should make clear that it is not addressing whether Appellee was the "true lender;" that issue has not been raised. If Appellee is the "true lender," then the Wisconsin choice-of-law provision would be void because it was selected for purposes of evading the Colorado usury laws. *Miller v. Tiffany*, 68 U.S. 298, 308 (1864).

Likewise, if the Court does embrace "valid-when-made," it should clearly enunciate the *ab initio* exception and remand the case for fact-finding about the circumstances of the assignment of the loan from Lake Mills Bank to World Business Lenders. It is not clear if the loan was always intended for assignment, but the known facts suggest that the loan might have been originated for assignment as part of a rent-a-bank transaction: a Colorado entity obtained a small business loan at 120.86% interest from a tiny Wisconsin community bank, which assigned the loan to World Business Lenders, a subprime small business lender whose website states that its loans are currently offered through a bank.

CONCLUSION

There was no "valid-when-made" doctrine prior to either the NBA or DIDA. The doctrine is a modern invention based on a misreading of *Nichols v. Fearson.* The doctrine is not implicit in the common law of assignments or in DIDA section 1831d. The doctrine is not valid, but made up. Whether such a doctrine should exist is properly the province of Congress, not the courts, and Congress has thus far declined to advance bills that would enact a "valid-when-made" doctrine.

Respectfully submitted this 19th day of September, 2019.

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by email upon the following, this 19th day of September, 2019:

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CERTIFICATE OF COMPLIANCE

I certify that this amicus curiae brief complies with the type-volume limitation of Federal Rule of Bankruptcy Procedure 8017(a)(5) (and 8015(a)(7)(B)) because it contains 6,496 words, excluding the parts of the brief exempted by Federal Rule of Bankruptcy Procedure 8015(g).

Dated this 19th day of September, 2019.

[redacted]

Professor Adam J. Levitin

APPENDIX A

http://www.bloomberg.com/news/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans.html

Bloomberg

Wall Street Finds New Subprime With 125% Business Loans

Zeke Faux
May 22, 2014, 12:00 AM EDT

Doug Naidus made his fortune selling a mortgage company to Deutsche Bank AG months before the U.S. housing market collapsed. Now he's found a way to profit from loans to business owners with bad credit.

From an office near New York's Times Square, people trained by a veteran of Jordan Belfort's boiler room call truckers, contractors and florists across the country pitching loans with annual interest rates as high as 125 percent, according to more than two dozen former employees and clients. When borrowers can't pay, Naidus's World Business Lenders LLC seizes their vehicles and assets, sometimes sending them into bankruptcy.

Naidus isn't the only one turning to subprime business lending. Mortgage brokers and former stock salesmen looking for new ways to make fast profits are pushing the loans, which aren't covered by federal consumer safeguards. Goldman Sachs Group Inc. (GS) and Google Inc. are among those financing his competitors, which charge similar rates.
"This is the new predatory lending," said Mark Pinsky, president of Opportunity Finance Network, a group of lenders that help the poor. "And the predators, just as they did in the mortgage market, have gotten increasingly aggressive."

Subprime business lending -- the industry prefers to be called "alternative" -- has swelled to more than $3 billion a year, estimates Marc Glazer, who has researched his competitors as head of Business Financial Services Inc., a lender in Coral Springs, Florida. That's twice the volume of small loans guaranteed by the Small Business Administration.
`Main Street'

Naidus, 48, chief executive officer of World Business Lenders, declined to be interviewed. Marcia Horowitz, a spokeswoman at public relations firm Rubenstein Associates Inc., said the company explains loan terms in plain English and takes steps to ensure that borrowers understand.

"World Business Lenders' sales and marketing techniques, as well as the interest rates it charges and the default rates it experiences, are generally consistent with those throughout the industry," Andy Occhino, general counsel for the company, wrote in a May 21 letter. "In serving the underserved small-business community along Main Street USA, World Business Lenders complies with all applicable laws and endeavors to ensure a positive experience for its customers."

Hurricane Damage

Maher and Tamer Kasem, a father and son who sell cigarettes and cosmetics to corner stores in Brooklyn and Philadelphia, are typical customers. They borrowed from World Business Lenders in December to keep their company afloat after being rejected by a bank and turned down for a hurricane-recovery loan.

A saleswoman initially talked about an unsecured $45,000 loan, they said. They had fallen further behind on bills by the time they received the final terms to borrow $12,500. The money, plus almost $1,000 in fees, was to be repaid over six months with $144.73 deducted from their bank account each business day, according to a contract they provided. That worked out to a total of $18,236 or an annualized rate, inclusive of fees, of about 110 percent.

Tamer and his mother Lamis said they signed personal guarantees that they would repay the money even if the business went bust, and the family put up a vacant lot as collateral.

"I was just wanting to get money to survive my business any way," Maher Kasem, 57, said in an interview at his office in the Bensonhurst section of Brooklyn, where he keeps boxes of fruit-flavored cigars and makeup ruined in Hurricane Sandy stacked on the crumbling tile floor. "They're slick."

World Business Lenders sued the Kasems and obtained a judgment for $22,828, which included a $3,879 prepayment fee. The firm hasn't yet foreclosed on the property, Kasem said.

Packaging Loans

Horowitz, the spokeswoman for World Business Lenders, said the company works with borrowers to avoid defaults.

"If the default cannot be cured, World Business Lenders enforces its rights under the loan documents, including the recovery of the pledged collateral," she said.

Wall Street banks are helping the industry expand by lending originators money. They're starting to package the loans into securities that can be sold to investors, just as they did for subprime-mortgage lenders.

OnDeck Capital Inc., a lender with funding from Google's venture-capital arm and PayPal Inc. co-founder Peter Thiel, sold $175 million of notes backed by business debt last month in a deal put together by Deutsche Bank. Interest rates on the loans ranged from 29 percent to 134 percent, according to a report from credit rater DBRS Ltd., which labeled most of the deal investment grade.

Representatives for Thiel, Google Ventures and Goldman Sachs, which lends money to OnDeck, declined to comment.

'Your Choice'

"While I am not real thrilled about some of the prices being charged, in some cases businesses need to get something done in a hurry and it makes sense," said William Dennis, who directs the research foundation at the National Federation of Independent Business. "It may not be the world's best choice, but at least it's your choice."

Brokers are popping up around the country to originate loans on behalf of lenders including OnDeck and World Business Lenders. The companies pay fees to the brokers of about $6,000 for finding people willing to take a $50,000 loan, according to current and former brokers, most of whom asked not to be identified to preserve their job prospects.

Some stock brokers have jumped to business loans after getting kicked out of the securities industry by regulators.

'Absolutely Crazy'

“Our industry is absolutely crazy,” said Steven Delgado, who left World Business Lenders last year to become an independent loan broker. “There’s lots of people who’ve been banned from brokerage. There’s no license you need to file for. It’s pretty much unregulated.”

David Glass, 39, was still on probation for insider trading when he co-founded Yellowstone Capital LLC, a New York-based brokerage and lender that originated $200 million in loans last year, including for OnDeck.

He said he learned to sell in the 1990s at Sterling Foster & Co., a Long Island firm where he got his friend a job interview that inspired “Boiler Room,” a movie that portrayed a college dropout’s foray into high-pressure stock sales. Glass said he coached actor Vin Diesel on cold-calling for the film. “A natural,” Glass said.

Glass said it’s a lot easier to persuade someone to take money than to spend it buying stock.

“The guys I worked with then were incredible sales guys,” Glass said. “I don’t really feel like we’re selling now because everyone we’re calling is an inbound phone call or they’ve filled out a form on the Internet.”

Breeding Money

Jonathan Cutler, a spokesman for New York-based OnDeck, said Yellowstone and World Business Lenders have originated less than 1 percent of the company’s loans this year. OnDeck drops brokers who charge upfront fees or send a lot of deals that go bad, he said. OnDeck also doesn’t require collateral.

“OnDeck customers are experienced, savvy people,” said Andrea Gellert, senior vice president of marketing for the company. “Since entering the market, OnDeck has brought down pricing significantly.”

Since Aristotle condemned the “breeding of money” as the worst way to make it around 350 B.C., societies have both enacted laws against usury and devised ways to work around them. New York State instituted a 25 percent interest-rate cap after a 1965 investigation found the Genovese crime family backing a Fifth Avenue business lender that charged 5 percent a week.

Usury Laws

Some loan companies avoid state usury laws by partnering with banks based in Utah, which doesn't cap rates. Others say "cash advances," repaid by collecting a share of businesses' credit-card sales, aren't loans. World Business Lenders lends in only about half of U.S. states and won't make loans in New York, according to its website. The loan to the Kasems was made in Pennsylvania, where they also do business.

"It's kind of the Wild West right now," said Nick Bourke, who studies small loans for the Pew Charitable Trusts, a research and policy group. "Online lending is raising lots of legal questions about which state law governs."

Naidus, described by colleagues as the best salesman they'd ever met, turned the brokerage he founded after graduating from Syracuse University in 1987 into one of the biggest mortgage originators in the nation. He took MortgageIT Holdings Inc. public and then arranged to sell it to Deutsche Bank in 2007 for $429 million. During the sale process, Naidus made at least $12 million selling his shares and options, and the bank agreed to hire him for $17 million in pay and guaranteed bonuses over two years, according to public filings.

MortgageIT Settlements

Even as MortgageIT's loans went bad during the financial crisis, Naidus earned the trust of top Deutsche Bank executives. He became global head of mortgages and helped start a home-loan joint venture in Saudi Arabia.

Like other banks that bought mortgage originators, Deutsche Bank ended up bearing the cost of allegedly fraudulent loans that helped fuel the housing bubble. The Frankfurt-based lender paid $202 million in 2012 and admitted MortgageIT arranged for government insurance on ineligible loans that soured.

Deutsche Bank also paid $12 million to settle U.S. allegations that the originator imposed higher fees and interest rates on black and Hispanic applicants. It denied those claims. Naidus wasn't a defendant in any of the cases.

Naidus made colleagues at Deutsche Bank aware of his wealth, one former co-worker said. He invited his bosses to play golf at the Bridge, a country club near his summer house in the Hamptons. The club cost $750,000 to join, the Wall Street Journal reported in 2007. He also owned a duplex on the Upper East Side of Manhattan that he bought for $6.2 million in 2005, real estate records show.

Sharia Lending

Naidus founded World Business Lenders in April 2011, according to a regulatory filing. He rented the 29th floor of an office tower on West 45th Street and began reassembling his lieutenants from the mortgage company. Naidus left Deutsche Bank the following year, said Renee Calabro, a spokeswoman for the bank in New York.
The business plan sounded promising, ex-employees said. Naidus said they'd build the largest small-business lender in the country and share the wealth when he took it public. He also created a company called Palm National Partners that would make loans to Muslims structured to avoid the sharia ban on charging interest.

"We are already helping so many entrepreneurs to realize their dreams," Naidus said in an undated video that was posted on World Business Lenders' website. "I can relate to every one of our customers because I am the prototype of our customer."

'Who Cares?'

World Business Lenders put up job listings seeking former brokers, and they came. A February orientation schedule provided by a former employee shows that training is run by Bryan Herman, who got his start under Stratton Oakmont Inc.'s Belfort, the con man portrayed in "The Wolf of Wall Street." Herman later ran his own boiler room in the 1990s and avoided jail by informing on other brokers when he was charged with fraud in 1998, court records show. Another salesman was released from prison in 2010 after serving about a year for penny-stock fraud.

Herman has paid for his crimes, according to his lawyer, Marty Kaplan.

"It's really like saying Bill Clinton smoked dope in college," Kaplan said. "Who cares?"

Cold-callers said they typically got paid a draw of $1,300 a month against commission. Four former employees said Naidus impressed them during job interviews with his success and intensity. He'd meet them in his office, which he decorated with a photo of himself striking a martial-arts pose with a sword, shirtless. One ex-colleague said Naidus liked to discuss his street-fighting skills. He looked like action star Jean-Claude Van Damme, another said.

'Money Factors'

Salespeople said they were told to refer to “short-term capital” instead of loans and “money factors” instead of interest rates. Eight of them said they talked business owners into applying by saying they’d offer a good rate after reviewing bank statements.

World Business Lenders charged most people 125 percent annualized interest rates on six-month loans regardless of their situation, five former employees said. The borrowers often put up cars, houses or even livestock worth at least twice as much as the loan. About one in five were going bust as of last year, two people with knowledge of the matter said. One said that 9 percent of the loans made this year have already defaulted.

“The sweet spot is someone who can limp along well enough for six months but probably isn’t going to be around much longer,” Opportunity Finance Network’s Pinsky said. “They’re in the business of helping these businesses fail.”

Sushi Lunches

Naidus took the top three salespeople at World Business Lenders to lunch each month, often choosing sushi, former colleagues said. The successful ones were given the preferred leads, people who had called in about loans. Those who didn’t close deals survived on $1 pizza slices for a month or two until they were fired.

Former employees said finding qualified borrowers willing to pay their rates proved more difficult than Naidus made it sound. Six said they questioned whether their business was legal. Two others said they wondered why the company seized cars that weren’t worth enough to cover the repo man’s fee.

“You know payday loans?” said Aleena Skinner, who worked for World Business Lenders for a few months in 2012 and is now a saleswoman for a copy-machine company. “I don’t really feel like high-interest loans are in anybody’s best interest.”

World Business Lenders makes $1 million to $3 million a month in loans and was running at a loss as of last year because so many borrowers weren’t paying, one former executive said. Naidus once joked that the business would be better off if it paid salesmen in repossessed Pontiacs, the person said.

Pizza Oven

Naidus's investors include Fahad Abdullah Al Rajhi, the son of one of the billionaire founders of Saudi Arabia's Al Rajhi Bank. Al Rajhi invested in Palm, the sharia-compliant part of the business, and brought in the Muslim scholar who blessed its practices, according to former employees.

Instead of lending, Palm buys an asset, such as a refrigerator or a pizza oven, and then leases it to the business owner. Other than that, the terms were the same. Finding Muslims to take the loans was hard, the ex-employees said. Messages left for Al Rajhi with his family's bank weren't returned.

Palm and World Business Lenders are legally separate entities and operate at arm's length, Horowitz said. Palm complies with all laws and isn't associated with the Al Rajhi family's bank, she said.

Tow Truck

Nick Frederick, 38, a tow-truck driver in Sykesville, Maryland, said the Islamic lender solicited him by e-mail and phone last year when he needed $15,000 to buy a trailer. The six-month "asset sale and lease" cost the equivalent of an annualized 96 percent interest rate, according to Frederick's contract. Frederick said a saleswoman assured him she would lower the rate in a few months and hire him to tow other people's cars.
"They were real friendly at first," he said. "I should have known better because it sounded too good to be true."

Frederick said he struggled to make the daily $166.98 payments when one of his trucks broke down, so he borrowed from his grandmother to pay off the contract early. Palm wouldn't accept his money, he said. Then without warning, he said, the company took his truck, along with a license-plate scanner and a laptop.

"I'm real close to going out of business because they're jerking me around," Frederick said. "Alls I want out of the deal is I want my property out of it, and I want my damn truck back."

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ATTACHMENT 3

Adam J. Levitin, Comment Letter to the Office of Comptroller of the Currency

Re: Docket No. OCC-2019-0027 (RIN 1557-AE73), January 5, 2020.

BankThink 'Madden fix' bills are a recipe for predatory lending

By Adam J. Levitin
Published August 28 2017, 10:24am EDT

More in Midland Funding v Madden, Policymaking, Payday lending, Online banking

Editor's note: This is an altered version of a post that originally appeared on the Credit Slips blog.

Currently pending in both houses of Congress are versions of the Protecting Consumers Access to Credit Act of 2017 — bills that would "fix" the 2015 appellate court decision in Madden v. Midland Funding LLC. Unfortunately, these so-called legislative solutions are based on a faulty reading of case law.

The Madden case held that National Bank Act preemption of state usury laws applies only to a national bank, and not to a debt collector assignee of the national bank. The decision has potentially broad implications for all secondary markets in consumer credit in which loan assignments by national banks occur: securitizations, sales of defaulted debt and rent-a-BIN lending.

Unfortunately, the "Madden fix" bills are overly broad and unnecessary and will facilitate predatory lending. Specifically, the Madden fix bills claim to be restoring the so-called "valid-when-made" doctrine, which, according to proponents of the legislation, means that the usurious or nonusurious nature of a loan is fixed at the time when the loan is made. The problem is that this particular doctrine is wholly concocted. There is a "valid-when-made" doctrine in commercial law, but it means something entirely different than the Madden fix proponents claim.

Bills to address concerns about the effects of the Madden court decision would facilitate predatory lending through schemes that have no purpose other than evading state usury laws.
Adobe Stock

The actual “valid-when-made” doctrine provides that the maker of a note cannot invoke a usury defense based on an unconnected usurious transaction. The basic situation in all of the 19th-century cases establishing the doctrine involves *X* making a nonusurious note to *Y*, who then sells the note to *Z* for a discount. The discounted sale of the note can be seen as a separate and potentially usurious loan from *Y* to *Z*, rather than a sale. The valid-when-made doctrine provides that *X* cannot shelter in *Y*'s usury defense based on the discounting of the note. Even if the discounting is usurious, it does not affect the validity of *X*'s obligation on the note. In other words, the validity of the note is a free-standing obligation, not colored by extraneous transactions.

“Valid-when-made” was a sensible and indeed critical rule for 19th-century commercial law. In the 19th century, negotiable instruments such as notes passed as currency, and their liquidity depended on them being “travelers without baggage,” such that parties could accept them without undertaking diligence beyond the four corners of the note itself. The rule is not only practical, but also just — why should *X* get a windfall because of *Y*'s separate dealings with *Z*?

But notice that the actual valid-when-made doctrine has absolutely nothing to do with the Madden situation. The consumer in the court case did not attempt to invoke the rights of the national bank against the debt collector. Instead, the consumer's argument was that the interest rate on the debt was usurious — and clear — under state law from the get-go. The state usury law's application is preempted by the National Bank Act as applied to national banks, but only as to national banks; the National Bank Act does not void the state usury law, only stay its application. Once the note leaves the hands of a national bank, the state usury law applies as it always would. This too is a sensible outcome. National banks are not subject to certain state laws because they are subject to an alternative federal regulatory regime. An assignee of a national bank is not subject to that regulatory regime, however, so it should not get that regime's benefits lest there be a regulatory vacuum. And because consumer debts are not used as currency, there is no policy reason to enhance their liquidity by excusing debt purchasers from basic diligence.

The point is that Madden did not reverse long-standing case law; the National Bank Act was not held to preempt state usury laws in any circumstances until 1978. Instead, Madden reversed some relatively recent assumptions of the financial services industry about the scope of National Bank Act preemption in secondary markets, the foundations of which I questioned in a 2009 article. The Madden fix bills are not restoring long-standing doctrine, but creating it out of whole cloth to meet the financial services industry's desires about what the law should be, not what it is.

The flawed legal foundations of the Madden fix bills also present another problem: They fail to incorporate an important corollary doctrine. The courts have consistently distinguished between a situation in which there is a legitimate loan and an unconnected usurious transaction, and situations in which the assignee is the true lender and the assignment is a sham. Thus, the sale of defaulted loans to a debt collector who has had no input in the loan's underwriting is entirely different under this doctrine than a rent-a-BIN operation, in which the assignee is substantially involved in marketing and underwriting the loans.

The Madden fix bills fail to distinguish between these situations. Instead of merely protecting relatively benign financial transactions, like credit card securitization or even facilitating a secondary market in defaulted loans, the Madden fix bills are actually facilitating predatory lending through rent-a-BIN and rent-a-tribe schemes that have no purpose other than the evasion of state usury laws and other consumer protections.

In any event, it's not clear that the Madden court decision poses any problem that needs fixing. The bills cite a single, unpublished academic study that shows that some marketplace lenders responded to Madden by limiting credit to borrowers with low FICO scores. The study does not indicate the total dollar amount of that credit contraction, much less if it was offset by increased lending from other sources, or its effect on consumer welfare. We simply don't know the net effect of Madden on credit markets.

Even if there were a net reduction in credit as a result of Madden, that access to credit must be balanced against sensible borrower protections. If access to credit were everything, we should be eliminating limitations on debt collection and allowing consumers to pledge their children and organs as collateral.

Usury laws are the oldest form of borrower protection known. They are blunt tools, but that is also their virtue, insofar as they are easy to administer. Congress should be hesitant to do a quickie, backdoor repeal of laws that have been on the books since colonial times, especially as state legislatures are free to repeal their usury laws directly.

It's reasonable to rethink the role of state usury laws in national credit markets, but any erosion of consumer protections on the state level must be matched by a strengthening of those protections on the federal level, such as with a federal usury floor or an ability-to-repay requirement. Sadly, the Madden fix bills don't do this, and instead gut state usury laws in the name of restoring an imaginary legal doctrine that never existed.

Adam J. Levitin

BankThink submission guidelines

<u>ATTACHMENT 3</u>

Adam J. Levitin, Comment Letter to the Office of Comptroller of the Currency

Re: Docket No. OCC-2019-0027 (RIN 1557-AE73), January 5, 2020.

GEORGETOWN LAW

Adam J. Levitin
Agnes N. Williams Research Professor
& Professor of Law

January 5, 2020

Office of Comptroller of the Currency
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RE: Docket No. OCC-2019-0027 (RIN 1557-AE73)

Dear Sir/Madam:

I write to strongly object to the Notice of Proposed Rulemaking (the "Proposed Rule") issued by the Office of Comptroller of the Currency (OCC) regarding "Permissible interest on loans that are sold, assigned, or otherwise transferred," Docket No. OCC-2019-0027.[1] Without claiming any statutory ambiguity, the Proposed Rule seeks to overturn the decision of the Second Circuit Court of Appeals in *Madden v. Midland Funding*,[2] to allow non-bank assignees of national banking associations to charge interest at the rates permitted to national banks pursuant to section 85 of the National Bank Act,[3] without regard to the usury laws of the borrower's state. In other words, the Proposed Rule would effectively preempt state usury laws in order to allow non-bank assignees to purchase loans with interest rates that exceed the rates allowed if the non-bank assigned had made the loans themselves. The Proposed Rule allows non-banks to do indirectly what they are forbidden to do directly, and in so doing endangers the safety-and-soundness of national banks and undermines consumer protections. As I detail below, the Proposed Rule is both illegal and bad policy. The OCC should retract the Proposed Rule.

[1] 84 Fed. Reg. 64229 (Nov. 21, 2019).
[2] 786 F.3d 246 (2nd Cir. 2015).
[3] 12 U.S.C. § 85.

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I. Qualifications

By way of background, I am the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center, where I teach courses in Consumer Finance, Financial Regulation, Contracts, Commercial Law, Structured Finance, and Bankruptcy. I have also previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School and as faculty for the Federal Trade Commission's Division of Financial Practices training program, and am elected member of the American Law Institute, which awarded me its Young Scholars Medal in 2013. I have also previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board and as an expert witness for the Federal Deposit Insurance Corporation in four related rent-a-bank litigations.[4]

Among my publications is the first law school textbook on consumer finance, ADAM J. LEVITIN, *CONSUMER FINANCE: MARKETS AND REGULATION* (Wolters Kluwer 2018), which includes a chapter devoted to usury laws, as well as materials on rent-a-bank lending and securitization. I have also written several journalistic articles about the so-called "valid-when-made" doctrine, as well as submitted amicus briefs about the doctrine in four cases, including one, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.), in which the OCC has also appeared as an amicus. The OCC was served electronically (at its consent) with my amicus brief in that case. I have attached a copy of the brief, which details the spurious nature of the valid-when-made doctrine and the fallacious claim of the applicability of the common law of assignments to the question of what interest a non-bank may charge as an appendix.

II. The Proposed Rule Is Illegal

The Proposed Rule is patently illegal for three reasons. First, the OCC is lacks delegated authority to undertake the rulemaking. The OCC has no authority to regulate interest charges by entities other than national banks, so it has no authority to undertake a rulemaking with such effect. Even if it had such authority, however, the OCC is bound by the *Madden* decision under the Supreme Court's *Brand X* jurisprudence because section 85 of the National Bank Act is unambiguous.

Second, the Proposed Rule fails to comply with the statutory requirements of the National Bank Act. All OCC rulemakings that have the effect of preempting state consumer financial laws are subject to the procedural requirements of section 25b(b) of the National Bank Act. The statute provides no exceptions. The OCC has not complied with the procedural requirements of section 25b(b), nor can the Proposed Rule meet the preemption standard of "significant interference" provided by section 25b.

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[4] FDIC v. Columbus Bank & Trust, Columbus, Georgia, FDIC-08-139b, FDIC-08-140k (2008); FDIC v. First Bank of Delaware, Wilmington Delaware, FDIC-07-256b, FDIC-07-257k (2007); FDIC v. First Bank & Trust, Brookings, South Dakota, FDIC-07-228b, FDIC-07-260k (2007); FDIC v. CompuCredit Corp., FDIC-08-033b, FDIC-08-034k (2008).

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Third, the Proposed Rule is arbitrary and capricious and therefore in violation of the Administrative Procedures Act.[5] The Proposed Rule is arbitrary and capricious for three reasons: it lacks an evidentiary basis; it ignores key evidence; it patently misapplies common law; and its solution does not actually address key aspects of the supposed problem. This section elaborates on the legal problems with the Proposed Rule.

A. The Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Goes Beyond the Scope of Congressional Delegation to the OCC

1. The Proposed Rule Goes Beyond the Scope of the OCC's Statutory Authority Because the OCC Has No Authority to Regulate Interest Charges by Non-banks

The Proposed Rule is illegal because it does not comply with the Administrative Procedures Act because it exceeds the scope of the OCC's statutory authority.[6]

The question this rulemaking addresses is whether the interest allowed to national banks under section 85 is affected by "sale, assignment, or other transfer," that is, whether the interest allowed under section 85 is permitted to a non-bank assignee. Congress has not delegated to the OCC the power to preempt state usury laws with respect to non-banks except as through the section 25b procedures. A rulemaking with this effect goes beyond the delegation to the OCC in section 93a to "carry out the responsibilities of the office"[7] because the OCC's responsibilities do not extend to non-banks. the OCC has no authority to interfere with state regulation of non-banks, except to the extent that such regulation "prevents or significantly interferes" with the exercise of a national bank's powers.[8]

The limited scope of the section 85 delegation is patent from the express language of section 85 of the National Bank Act, which refers only to the rate of interest charged by a national banking "association." The reference in section 85 to a national banking "association" inherently excludes all other entities, including all non-banks, from the scope of the provision. There is no ambiguity about what "association" means, and the OCC has not claimed any ambiguity regarding the text of section 85.[9] The scope of the OCC's interpretive authority under section 85 is limited to interest *for banks*.

Indeed, the limited authority in section 85 is clear from comparison with other statutory provisions in title 12. Congress has itself acted to preempt state usury laws with respect to non-banks in a specific context, namely in regard to first lien mortgage loans.[10] Moreover, that same provision expressly preempts state law even in the event of an

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[5] 5 U.S.C. § 706(2)(A).

[6] 5 U.S.C. § 706(2)(C).

[7] 12 U.S.C. § 93a.

[8] 12 U.S.C. § 25b(b).

[9] Nor is there any ambiguity about the term "interest" at issue in the Proposed Rule. This is not a situation like that in addressed by the Supreme Court in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996), regarding what sort of charges are included in the term "interest."

[10] 12 U.S.C. § 1735f-7a.

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assignment.[11] That Congress has acted to preempt state usury laws for assignees other than national banks in another context implies a lack of authority for the OCC to act more broadly under section 85.

2. *The OCC Is Bound by Madden v. Midland Funding, LLC and Has No Authority to Undertake the Proposed Rulemaking*

The Proposed Rule seeks to overturn the result of the Second Circuit's ruling in *Madden v. Midland Funding, LLC*.[12] The OCC does not appear to realize that it is in fact bound by the Second Circuit's interpretation of the National Bank Act in *Madden* absent any contrary judicial authority. It does not matter that the OCC was not a party to Madden; the question is not one of issue preclusion, but one of *Chevron* jurisprudence. The OCC has authority to interpret the National Bank Act, but only to the extent that the statute is ambiguous. If the statute is unambiguous and the OCC must defer to prior judicial authority, irrespective of whether it was party to such prior case.[13] Thus in *United States v. Home Concrete & Supply, LLC*, the Supreme Court held that a Treasury regulation did not supplant a prior judicial interpretation of the statute because the statute was unambiguous.[14] Likewise, in *National Cable & Telecommunications Association v. Brand X Internet Services*, the Supreme Court held that "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[15]

Although the Supreme Court held that the statute in at issue in *Brand X* was ambiguous, the Circuit Court decision it reversed had applied a prior precedent against the challenged rulemaking even though the agency that promulgated the rule had not been a

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[11] 12 U.S.C. § 1735f-7a(a)(1)(C)(v). I note that Congress enacted this provision at the very same time that it enacted 12 U.S.C. § 1831d, the equivalent provision to section 85 for state insured banks. That Congress chose to address assignees in one provision and not in the other provision (that mirrors section 85) strongly indicates that Congress did not intend section 1831d (or section 85 by implication) to apply to assignees.

[12] 786 F.3d 246 (2nd Cir. 2015).

[13] The idea that the OCC should get any *Chevron* deference is further undermined by the fact that the OCC filed a brief with the Supreme Court opposing certiorari in *Madden*. While that brief did note that the OCC disagreed with *Madden*'s holding, it argued that the case was an inappropriate vehicle to address the case. In other words, the OCC had an opportunity to litigate the *Madden* case and declined to do so. The OCC cannot oppose certiorari because it believes that a case it an inappropriate vehicle for the courts to address a case and then decide that *it* is the appropriate entity to address an unambiguous statute. This sort of gamesmanship is beyond anything allowed by administrative law.

[14] 566 U.S. 478, 486-487 (2012).

[15] 545 U.S. 967, 982 (2005). I noted, however, that under section 25b of the National Bank Act, the OCC's rulemaking would not be entitled to *Chevron* deference. 12 U.S.C. § 25b.

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party to that prior litigation.[16] Subsequent Circuit Court opinions have made clear that when a statute is unambiguous, agencies are bound by prior judicial interpretation and that it is not necessary for the court to have expressly stated that the statute was unambiguous for the agency to be bound.[17]

In this instance, the Second Circuit ruled in *Madden* to interpret the unambiguous text of section 85 of the National Bank Act. This means that the OCC is bound under *Madden* regarding the interpretation of section 85 of the National Bank Act; the OCC's policy preferences are irrelevant in this regard. Accordingly, the Proposed Rule goes beyond the scope of the Congressional delegation to the OCC and is in violation of the Administrative Procedures Act.[18]

B. The Proposed Rule Fails to Comply with the Procedural Requirements of the National Bank Act and Is Therefore Illegal under Both the National Bank Act and the Administrative Procedures Act

The Proposed Rule is illegal because it fails to comply with the procedural requirements of section 25b of the National Bank Act.[19] Section 25b is a new section of the National Bank Act, added as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 25b is a sharp Congressional rebuke of the OCC's aggressive campaign of preemption of state consumer financial laws during the 1990s and 2000s, which contributed directly to the financial crisis. Indeed, there is no provision in the entire Dodd-Frank Act that is a more direct reproach of a federal agency's pre-financial crisis actions other than the outright elimination of the Office of Thrift Supervision.

Section 25b(b) provides that:

> State consumer financial laws are preempted only if…in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996), the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law.[20]

The OCC has not made any determination regarding preemption in the Proposed Rule on a case-by-case basis as defined in section 25b(b)(3). Nor is the Proposed Rule supported by *any* evidence, much less the "substantial evidence, made on the record of the proceeding," required by section 25b(c). Accordingly, the Proposed Rule is illegal because it does not

[16] 545 U.S. 967 (2005).

[17] *See, e.g.*, Texas v. Alabama-Coushatta Tribe of Texas 918 F.3d 440 (5th Cir. 2019); Patel v. Napolitano, 706 F.3d 370 (4th Cir. 2013).

[18] 5 U.S.C. § 706(2)(C).

[19] 12 U.S.C. § 25b.

[20] 12 U.S.C. § 25b(b)(1)(B).

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comply with the procedural requirements of the National Bank Act for preemption of state consumer financial laws, much less the evidentiary burden.

The OCC has previously failed to comply with section 25b's requirements when enacting the current preemption regulations in 12 C.F.R. Part 7, Subpart D. As a result, the entirety of these existing preemption regulations are illegal.[21] The OCC's continued unwillingness to abide by section 25b's procedures suggest that the OCC has not properly internalized the Congressional censure in that provision and is simply defying a clear statutory directive.

Alternatively, it is possible that the OCC's failure to adhere to the requirements of section 25b for the instant Proposed Rule is because the OCC believes that section 25b is inapplicable to a rule made under section 85. If so, the OCC is incorrect. *All* OCC rulemakings that preempt state consumer financial laws must comply with section 25b's procedural and evidentiary requirements. Section 85 is not excepted from section 25b's requirements.[22]

The procedural requirements for preemption of state consumer financial laws are found in section 25b(b), while the evidentiary standards necessary to support a rulemaking with a preemptive effect are found in both sections 25b(b) and 25b(c). Section 25b(b) is absolute in its statement that of the preemption standard: "State consumer financial laws are preempted only if…[there is a finding through the requisite procedures of significant interference or prevention of the exercise of a national bank's powers]." No exception is stated to this rule.

To the extent that the OCC is relying on section 25b(f) as creating an exception for rules promulgated under section 85, it is incorrect. Section 25b(f) is not an exception to section 25b(b). Section 25b(f), entitled "Preservation of Powers Related to Charging Interest" states that:

> No provision of title 62 of the Revised Statutes shall be construed as altering or otherwise affecting the authority conferred by section 85 of this title for the charging of interest by a national bank at the rate allowed by the laws of the State territory, or district where the bank is located…[23]

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[21] *See* Lusnak v. Bank of America, N.A., 883 F.3d 1185 (9th Cir. 2018).

[22] Even if section 85 were itself exempt from section 25b's procedural and evidentiary requirements, the Proposed Rule would still be subject to these requirements because it is not undertaken solely to facilitate national banks' most favored lender power. It is also undertaken to facilitate national bank's power to assign loans as evidenced by the OCC's discussion about the importance of loan assignments for bank risk management and liquidity. The power to assign loans arises under section 24(Seventh) of the National Bank Act, and preemption of state consumer financial laws under that section is, without question subject to the procedural and evidentiary requirements of section 25b. Either way, the Proposed Rule must comply with the procedural and evidentiary requirements of section 25b. It does not.

[23] 12 U.S.C. § 25b(f).

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Even assuming that section 25b(f)'s reference to a "provision of title 62 of the Revised Statutes" is actually meant to include the Dodd-Frank Act itself, section 25b(f) is still not a general exception to section 25b(b), much less for any entities other than national banks themselves.

First, if section 25b(f) were meant to be an exception to 25b(b), it would be drafted as "notwithstanding subsection (b) of this section," or the like. It is not drafted as such. Congress knows how to draft legislative exceptions to rules, and section 25b(f) does not read as one.

Second, the meaning of section 25b(f) is difficult to determine,[24] but it must be read *in pari materia* with sections 25b(e) and 25b(h). Section 25b(e) provides that notwithstanding any provision of title 62 of the Revised Statutes (including, under this reading, the Dodd-Frank Act and thus section 25b(f)), state consumer financial law shall apply the same to a subsidiary or affiliate of a national bank (other than those that are themselves national banks) as to any other non-bank entity.[25] Section 25b(h) provides that "No provision of title 62 of the Revised Statutes [including, again, under this reading, the Dodd-Frank Act and thus section 25b(f)]…shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate, or agent of a national bank…"[26]

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[24] Arguably, section 25b(f) is meant to clarify that section 25b is not changing the law *as it existed in 2010 when the Dodd-Frank Act was enacted.* Put another way, section 25b(f) is saying that section 25b(b) does not change the existing application of section 85, meaning that it preserves judicial glosses like *Marquette National Bank v. First of Omaha Service Corporation*, 439 U.S. 299 (1978). and *Smiley v. Citibank (South Dakota) N.A.*, 517 U.S. 735 (1996). Section 25b(f), however, says nothing about new interpretative extensions of section 85. Such new interpretative extensions of section 85 are subject to the procedural and evidentiary requirements of sections 25b(b) and 25b(c).

The OCC's Proposed Rule is not simply a restatement of the law as of 2010. Instead, it is a new, expansive interpretation of section 85 beyond the state of the law in 2010. As of 2010 there were virtually no judicial decisions about whether non-bank assignees of national banks were able to shelter in section 85. The only pre-Dodd-Frank decisions touching on the issue, *Krispin v. May Department Stores*, 218 F.3d 919 (8th Cir. 2000), and *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2005). were decided in the procedural context of removal for federal question jurisdiction, rather than on the merits. Moreover, these decisions were both explicitly tied to the unique factual circumstances of the case, rather than absolute statements of blanket rules like the one proposed by the OCC. Indeed, the unique circumstances were why the Second Circuit readily differentiated these cases in *Madden*, 786 F.3d 246 (2nd Cir. 2015). Most critically, *Krispin* was effectively overturned by section 25b(e) because *Krispin* involved the question of whether section 85 extended to an assignee that is an affiliate of a national bank. *Phipps* simply follows *Krispin*, so the overturning of *Krispin* puts it into question.

[25] 12 U.S.C. § 25b(e).

[26] 12 U.S.C. § 25b(h).

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Whereas section 25b(f) refers to a "national bank," sections 25b(e) and 25b(h) refer to national banks' subsidiaries, affiliates, and agents that are not themselves national banks. Thus, whatever section 25b(f) and section 85 are doing, it does not extend to the subsidiaries, affiliates, or agents of national banks, and, by implication, to any non-banks.[27]

It would be absurd to prohibit subsidiaries, affiliates, and agents of national banks from sheltering in section 85, while permitting other non-bank entities to do so. Subsidiaries, affiliates, and agents are all subject to federal regulatory oversight, but other non-bank assignees, are either state-regulated or even unregulated foreign entities. For less regulated entities to gain a regulatory privilege denied to more regulated entities is absurd. If the benefits of section 85 are denied to affiliates, subsidiaries, and agents, *a fortiori* they are denied to unconnected entities. Accordingly, section 25b(f) cannot be read as an exception to section 25b(b).

Because there is no exception to section 25b(b), its procedural requirements apply to any OCC rulemaking that preempts state consumer financial law, including this one, and that means that the Proposed Rule is illegal because it fails to comply with the section 25b(b) requirements. Therefore, it is illegal not just under the National Bank Act, but also under the Administrative Procedures Act because it is "without observance of procedure required by law."[28]

C. The Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Is Arbitrary and Capricious

1. The Proposed Rule Is Arbitrary and Capricious Because It Lacks Any Evidentiary Basis

On top of the OCC's lack of authority for the rulemaking, the Proposed Rule fails to comply with the Administrative Procedures Act because it is arbitrary and capricious because it lacks an evidentiary basis.[29] The Proposed Rule claims that it is necessary to protect national banks' ability to sell loans without any evidentiary basis of this in fact being a problem post-*Madden*. Specifically, the OCC claims that "banks of all sizes continue to routinely rely on loan assignments and securitization to access alternative funding sources, manage concentrations, improve financial performance ratios, and more efficiently meet customer needs."[30] The OCC has adduced zero data to support this claim, which is in fact misleading. While banks of all sizes engage in residential *mortgage* securitization, most mortgage loans are already exempt from state usury laws.[31] Only a handful of the very largest banks engage in securitization of any other asset class. Other than securitization, banks rarely assign loans

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[27] The Proposed Rule does not distinguish between assignees based on whether they are subsidiaries, affiliates, or agents of national banks or not. Accordingly, even if section 25b's procedures do not apply to the Proposed Rule, the scope of the Proposed Rule is broader than that allowed under section 25b(f) and 25b(h).

[28] 5 U.S.C.§ 706(2)(D).

[29] 5 U.S.C. § 706(2)(A).

[30] 84 Fed. Reg. 64231 (Nov. 21, 2019).

[31] 12 U.S.C. §§ 1735f-7, 1735f-7a.

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to non-banks other than selling charged-off debts (for pennies on the dollar) or as part of rent-a-bank partnerships in which banks originate loans according to a non-bank's specifications for sale to a non-bank.

The truth is that the OCC has no idea how many, if any, national banks are materially engaged in making loans with interest rates exceeding state usury caps, just as it has no idea how frequently national banks assign such loans, or even assign loans in general. More generally, the OCC has presented no evidence that the sale of debt obligations with interest rates that exceed state usury caps is a material source of liquidity for any bank, much less for banks in general. Indeed, banks obtain liquidity primarily through the incurrence of liabilities—accepting deposits—and through borrowing via repurchase agreements (repos), correspondent bank lines, Federal Home Loan Bank advances, and the Federal Reserve's discount window. Banks do not generally rely on the sale of non-mortgage assets as a key liquidity source.

It is worth noting that the FDIC, in its parallel rulemaking concedes that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected."[32] Similarly, the FDIC concedes in its parallel rulemaking that it does not have information regarding the number of small entities that have been directly affected by ambiguity resulting from *Madden*.[33] Just as the FDIC lacks this information on small banks, so too does it lack it on banks generally because the FDIC does not collect the relevant information from any banks. The same is true regarding the OCC and national banks. The Proposed Rule cannot stand on naked assertions about the importance of asset sales to bank liquidity generally and on the further implicit assumption that banks rely on sales of loans with interest rates exceeding state usury caps as an important source of liquidity. There is no evidentiary basis whatsoever for either assertion. Accordingly, the rule is arbitrary and capricious.

2. *The Proposed Rule Is Arbitrary and Capricious Because It Ignores Key Contrary Evidence*

Not only does the Proposed Rule lack an evidentiary basis, but it entirely ignores some of the most obvious and contrary evidence. Accordingly, it is arbitrary and capricious and

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[32] 84 Fed. Reg. 66850 (Dec. 6, 2019). *See also id.* at 66852 ("The FDIC is not aware of any broad effects on credit availability having occurred as a result of *Madden*.…the FDIC believes the number of institutions materially engaged in making loans [with interest rates exceeding state usury caps] to be small.").

[33] 84 Fed. Reg. 66851 (Dec. 6, 2019). FDIC likewise concedes that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected." *Id.*

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therefore in violation of the Administrative Procedures Act.[34] While the Proposed Rule contends that it is necessary to protect bank liquidity, the idea that state usury laws actually constrain bank liquidity is preposterous. Banks may always sell loans to other banks. There are over 5,200 federally insured depositories, so there is a robust market for national bank loans simply from national banks and insured state banks, none of which are subject to state usury laws. Nowhere in the Proposed Rule is this enormous market for bank loans ever mentioned.

Additionally, the Proposed Rule ignores that state usury laws do not actually prevent the sale of bank loans to non-banks, even if the loans have interest rates that exceed state usury caps. The loan purchaser may always choose to forgo collecting interest that exceeds the state usury cap. If the purchaser does so, it is likely to discount what it will pay on the purchase price. As the Second Circuit noted in *Madden*, while the sale price of the loans may be lower than otherwise, the National Bank Act is not a retail price maintenance statute. There is a world of difference between ensuring that there is a market for bank loans and insisting that banks get the best possible price for their loans.

Because the Proposed rule ignores obvious contrary evidence—failing to give it any consideration whatsoever—it is arbitrary and capricious.

3. *The Proposed Rule Is Arbitrary and Capricious Because It Is Based on a Patent Misapplication of the Common Law*

The OCC claims that Proposed Rule is based on the principles found in the common law of assignments and the so-called "valid-when-made" doctrine.[35] This is incorrect on both counts. Neither the common law of assignments or the actual valid-when-made doctrine supports the Proposed Rule. A rule that is founded on a patent misrepresentation of the law is arbitrary and capricious and "otherwise not in accordance with law" and therefore violates the Administrative Procedures Act.[36]

i. The Proposed Rule Misapplies the Common Law of Contracts

The OCC contends that the Proposed Rule is consistent with the common law of contract assignment, which generally allows an assignee to accede to all of the rights of the assignor under the contract. While this is an accurate characterization of the law of contracts, it is a misapplication of the common law of contracts to the question of whether a national bank's most favored lender status under section 85 of the National Bank Act is assignable.

The common law of assignments relates solely to the assignment of rights under a contract or property rights. It has no bearing on whether federal statutory status or privileges may be assigned. A national bank's most favored lender status is a function of statute, not contract. Most favored lender status cannot arise from contract because contract cannot displace state usury statutes and other state regulations. Because essence a personal privilege, not a property right it is no more assignable than a medical license or a tax-exempt status or a national bank's trust powers or discount window access. If these privileges were freely

[34] 5 U.S.C. § 706(2)(A).

[35] 84 Fed. Reg. 64231 (Nov. 21, 2019).

[36] 5 U.S.C. § 706(2)(A).

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assignable there would be no point in having a licensing regime like national bank chartering because regulators would not exercise control over who ultimately gained the privileges attached to the license. Accordingly, the common law of assignments has nothing whatsoever to do with the assignability of most favored lender status.[37]

ii. The Proposed Rule Misapplies the So-Called "Valid-When-Made" Doctrine

The OCC also claims that the Proposed Rule is supported by the so-called "valid-when-made" doctrine. The OCC claims that this doctrine means that if a loan was valid when it was made for purposes of state usury law, it cannot thereafter cease to be valid by virtue of an assignment. The OCC's claim is founded on a blatant misreading of historical cases. There has never been a valid-when-made doctrine such as the one the OCC claims. Instead, to the extent that any sort of valid-when made doctrine exists, it is about the *calculation* of the interest rate on a loan, not about what law determines the applicable usury rate.

In support of the Proposed Rule, the OCC cites a pair of 19th century Supreme Court decisions, *Nichols v. Fearson*[38] and *Gaither v. Farmers & Mechs. Bank of Georgetown*,[39] as standing for a "cardinal rule[] in the doctrine of usury," namely that "if a loan is non-usurious at origination, the loan does not subsequently become usurious when assigned."[40] That is a blatant mischaracterization of these decisions. The Supreme Court held in both cases that the interest imputed from a discounted sale of a loan would not be added to the stated interest rate on the loan for the purpose of calculating whether *the assignor* violated state usury law. The cases had absolutely nothing to do with what interest rate the *assignee* could charge.

I have written at length previously about the ahistoricity of the valid-when-made doctrine as claimed by the OCC. In particular, I refer the OCC to an amicus brief I filed in a federal district court cased captioned *Rent-Rite Super Kegs West Ltd. v. World Business Lenders,* LLC, 1:19-cv-01552- REB (D.Colo.). OCC also appeared as an amicus in this on-going litigation, and my brief was served on the OCC electronically per the OCC's consent. I have attached the brief as an appendix to these comments. It shows that the historical cases relied up for a "valid-when-made" doctrine have absolutely nothing to do with the ability of a non-bank assignees of a bank to shelter in the bank's ability to export interest rates under section 85. Instead, to the extent that such a doctrine has ever existed, it deals with three distinct issues related to the calculation of the interest rate, not the question of what law applied. I note here that in its amicus brief in the *Rent-Rite* litigation the OCC engaged in

[37] The Seventh Circuit simply erred in this regard in *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005). In any event, the Seventh Circuit was sitting in diversity jurisdiction and its pronouncements on state common law of contracts law are not controlling.

[38] 32 U.S. (7 Pet.) 103, 109 (1833).

[39] 26 U.S. (1 Pet.) 37, 43 (1828).

[40] 84 Fed. Reg. 64231 (Nov. 21, 2019).

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more extensive selective and even misleading quotation from other cases, not one of which actually supports its position in the Proposed Rule.

4. The Proposed Rule Is Arbitrary and Capricious Because Its Solution Fails to Address an Important Aspect of the Supposed Problem

Finally, the Proposed Rule is arbitrary and capricious and therefore violates the Administrative Procedures Act because its solution entirely fails to address an important aspect of the problem of market uncertainty regarding interest rate assignment—the "true lender" doctrine.[41] The OCC notes the problem of uncertainty after the *Madden* decision, but the truth is that the uncertainty about what interest rate a non-bank assignee of a national bank may charge did not begin with *Madden* in 2015. Instead, it began in 2004 with the inclusion of a "true lender" provision in the Georgia Payday Loan Act,[42] and subsequent litigation.[43] Since 2004, several courts have adopted a similar "true lender" doctrine as a matter of state common law,[44] and such a provision is also consistent with 19th and early 20th century federal common law to disregard sham transactions for usury purposes.[45]

True lender doctrine and the question of whether a non-bank assignee may shelter in section 85 are inextricably intertwined. The Proposed Rule explicitly states that it does not

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[41] 5 U.S.C. § 706(2)(A). *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 43 (1983) (noting that an agency rule is "arbitrary and capricious" if the rule "entirely failed to consider an important aspect of the problem"); *see also* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971) (holding that, in assessing whether a rule is arbitrary and capricious, "the ultimate standard of review is a narrow one").

[42] OCGA § 16-17-1(c).

[43] Ga. Cash Am. v. Greene, 318 Ga. App. 355, 361-362 (Ga. Ct. App. 2012).

[44] Easter v. Am. West Fin., 381 F.3d 948, 957-959 (9th Cir. 2004) (applying true lender doctrine under Washington State law); Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012) (noting that, "where a plaintiff has alleged that a national bank is the lender in name only, courts have generally looked to the real nature of the loan to determine whether a non-bank entity is the de facto lender"); CashCall, Inc. v. Morrisey, 2014 W. Va. LEXIS 587, at* 43 2014 WL 2404300, at *14 (W.Va. May 30, 2014) (looking to form, not substance under West Virginia law); Pennsylvania v. Think Fin., Inc., 2016 U.S. Dist. LEXIS 4649, *30-33, 2016 WL 161597 (E.D. Pa. Jan. 14, 2016, upholding complaint based on true lender doctrine under Pennsylvania law); Consumer Fin. Prot. Bureau v. CashCall, Inc., 2016 U.S. Dist. LEXIS 130584, *15-16 (C.D. Cal. 2016) (form, not substance determines who is the true lender); Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134, 1150-1151 (D. Colo. 2018) (declining to dismiss a complaint predicated on true lender doctrine under Colorado law); Meade v. Marlette Funding LLC, 2018 U.S. Dist. LEXIS 46814, *8-9, 2018 WL 1417706 (D. Colo. Mar. 21, 2018) (same); CashCall, Inc. v. Md. Comm'r of Fin. Regulation, 448 Md. 412, 436, 139 A.3d 990, 1005, 2016 Md. LEXIS 371, *36 (Md. Ct. App. 2016) (holding a party that was the de facto lender was a "credit services business" subject to Maryland usury law).

[45] Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

take a position on true lender issues.[46] Without addressing true lender doctrine, the rule fails to materially reduce any uncertainty about what interest rate is permissible on a loan assigned by a national bank. As such, the proposed rule is arbitrary and capricious and therefore illegal under the Administrative Procedures Act because its solution does not address a key aspect of the problem it identifies.

III. The Proposed Rule Is Bad Policy

The Proposed Rule is non-mandatory and it should be retracted because it is bad policy. The Proposed Rule is contrary to the OCC's duties to ensure the safety and soundness of national banks and consumer protection from predatory lending.

A. The Proposed Rule Does Not Actually Enhance National Banks' Liquidity

The OCC claims that the Proposed Rule helps protect and enhance national banks' liquidity and risk management and that "[t]his risk management tool would be significantly weakened if the permissible interest on assigned loans were uncertain or if assignment of the permissible interest were limited only to third parties that would be subject to the same or higher usury caps."[47] This is incorrect. The Proposed Rule does not materially enhance national banks' liquidity or risk management capabilities, and the OCC has adduced no evidence that it does. This is because a national bank can already always sell loans—no matter the interest rate—to any of the more than 5,200 other FDIC-insured banks in the United States. A potential market of over 5,200 buyers "subject to the same or higher usury caps" is not a constrained market, nor does the OCC present any evidence that it is. The claim that limiting the market for usurious loans to over 5,200 banks "significantly weaken[s]" bank risk management is unsupported and frankly preposterous.

Moreover, national banks can already always sell loans—no matter the interest rate—to any non-bank. *Madden* did not change this situation by one iota. The only catch is that because under *Madden* the non-bank cannot collect the usurious interest, it will discount the purchase price, but there is a difference between preserving liquidity and maintaining resale prices. The Second Circuit found in *Madden* that this would not be a "significant interference" with a national bank power, and the OCC has not claimed otherwise in the Proposed Rule.

Additionally, as noted above, the Proposed Rule presents no evidence that most banks in fact rely on the loan sale market to non-banks for liquidity. Only the very largest banks engage in securitization of any assets other than residential mortgage loans. While banks will sell charged off loans to non-bank debt buyers, this is not a material source of liquidity for banks, and only one OCC-regulated institution currently engages in rent-a-bank transactions. Instead, banks' primary sources of liquidity are deposits and wholesale funding markets, as well as Federal Home Loan Bank advances, and the GSE cash windows, with the

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[46] 84 Fed. Reg. 64232 (Nov. 21, 2019).
[47] 84 Fed. Reg. 64231 (Nov. 21, 2019).

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Federal Reserve's discount window as a backup. To suggest that *Madden* has materially threatened bank liquidity is preposterous and unsupported by any evidence.

Moreover, if uncertainty about what usury cap applies to a non-bank assignee is the problem, the OCC's Proposed Rule presents no solution, as discussed above, because it does not remove the uncertainty that comes from true lender doctrine.

B. The Proposed Rule Facilitates Rent-a-Bank Arrangements That Pose Pipeline and Reputational Risk for National Banks

Rather than provide a material enhancement of bank liquidity, the Proposed Rule merely facilitates rent-a-bank lending arrangements, by which I mean arrangements where a bank agrees in advance to make loans according to a non-bank's specifications and to transfer a substantial economic interest in those loans to the non-bank (or its affiliate). Rent-a-bank arrangements are an inherent threat to the safety-and-soundness of national banks because of the pipeline and reputational risks involved. If the non-bank fails to honor its commitment to purchase the economic interest in the loans, the national bank will be stuck with the risk of a bunch of loans that by definition it would never have made for its own account. Moreover, because the sole reason for non-banks to engage in rent-a-bank lending is the evasion of state usury laws, there is reputational risk for national banks because they will be associated with predatory lending, which may hurt their other lines of business.

C. The Proposed Rule Facilitates Predatory Lending and Is Contrary to the OCC's Consumer Protection Mandate

Because the Proposed Rule facilitates rent-a-bank lending arrangements, it undermines state consumer protection laws. Rent-a-bank lending enables non-banks to make loans indirectly that they are forbidden to make directly. Whatever the OCC may think of the wisdom of state usury laws and state laws restricting various types of loan fees, these laws are on the books and apply to non-banks, and it is not the OCC's place to second-guess them or attempt to undermine them. The CFPB has brought enforcement actions for unfair and deceptive and abusive acts and practices for rent-a-tribe lending relationships. The OCC, which enforces the same statute, should similarly discourage, rather than facilitate analogous rent-a-bank relationships. Indeed, historically the OCC has done precisely that; I am aware of only one OCC regulated institution, Axos Bank, a federal savings association, that currently engages in rent-a-bank arrangements through its partnership with World Business Lenders, LLC, a subprime small business lender.

D. The Proposed Rule Would Create a Regulatory Vacuum and Undermine the Value of a National Bank Charter

National banks are allowed the privilege of interest rate exportation under section 85, as interpreted by *Marquette National Bank v. First of Omaha Service Corporation*.[48] That privilege, however, comes with being subject to a comprehensive federal regulatory regime, including regular federal examination by the OCC or CFPB for compliance with consumer financial laws. Non-bank assignees of national banks are not subject to such a regulatory

[48] 439 U.S. 299 (1978).

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regime. Unless they fall into certain enumerated types of institutions,[49] they are not subject to any sort of federal supervisory authority for compliance with consumer financial laws. Indeed, non-bank assignees of national banks may not even be subject to *state* supervision, as they need not be state-licensed. For example, a national bank might assign loans to an off-shore special purpose entity, such as a Cayman Islands trust, which would be entirely outside the scope of any US regulatory authority.[50]

Congress has allowed national banks the privilege of interest rate exportation because it is confident that the OCC's careful regulatory stewardship of national banks will be an adequate substitute for any particular state's usury laws. Allowing unregulated non-banks to take advantage of banks' interest rate exportation undermines that trade-off and creates a regulatory vacuum in which there is no meaningful consumer protection.[51]

Indeed, the Proposed Rule would also undermine the value of a national bank charter. If a non-bank can simply acquire the privileges of a national bank by paying a national bank a fee for those privileges it desires a la carte, the value of a national banking charter would be reduced. While this might be the OCC's ultimate goal—to co-opt so-called "fintechs" into bank partnerships in lieu of its controversial "fintech charter" proposal that is subject to on-going litigation, it is ultimately bad for the prestige and value of the national banking charter. The national banking charter was originally promulgated based on the belief that regulation by the OCC signaled the financial strength and operational quality of a bank, such that consumers would purchase that bank's national bank notes. If national banks simply rent out their charters, the charter will lose its value.

E. The Proposed Rule Fails to Exclude Assignments Undertaken to Evade State Usury Laws

There are some loan sale transactions, such as securitizations, that do not raise inherent consumer protection consumers, even if they do not currently comply with state usury laws. But the Proposed Rule fails to differentiate between benign transactions and malignant ones. In particular, it fails to exclude transactions undertaken to evade state usury laws, even though the anti-evasion principle is core to usury jurisprudence and were part of the immediate legal background of the National Bank Act.[52]

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[49] 12 U.S.C. §§ 1867, 5514.

[50] Elevate Financial, a fintech that has rent-a-bank relationships with two insured state banks, uses a Cayman Islands special purpose vehicle to purchase loan participations from those banks. *See* Kadhim Shubber, *Why this subprime lender funds loans through the Cayman Islands*, FIN. TIMES, Jan. 29, 2016, https://ftalphaville.ft.com/2016/01/19/2150488/why-this-texas-subprime-lender-routes-loans-through-the-cayman-islands/.

[51] Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 143, 176 (2009).

[52] *See* Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

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I strongly urge the OCC, if it persists in this ill-advised rulemaking, to include a provision that clearly excludes rent-a-bank arrangements and other assignments undertaken for the primary purpose of evading state usury laws. Doing so would not only be consistent with the OCC's consumer protection mandate—for Congress has not yet generally preempted state usury laws, even for national banks, only allowed rate exportation—but also because it is the only position that is consistent with well-established Supreme Court precedent.

Conclusion

The Proposed Rule is illegal and misguided. I urge the OCC to abandon the Proposed Rule and get back to its job of ensuring consumers protection and the safety-and-soundness of national banks. The OCC should not mistake the protection of profits at the handful of bad actor banks that engage in rent-a-bank arrangements with its job of husbanding the national banking industry for the benefit of American consumers.[53] The OCC should retract the Proposed Rule.

Sincerely,

[redacted]

Adam J. Levitin

Attachments:

(1) Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).
(2) Adam J. Levitin, *'Madden fix' bills are a recipe for predatory lending*, Am. Banker, Aug. 28, 2017, https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending.

[53] As Sir Thomas More notes in Richard Bolt's *A Man for All Seasons*, "For Wales? Why Richard, it profit a man nothing to give his soul for the whole world. . . but for Wales!" So too, the OCC is giving its soul for a handful of bad actor rent-a-banks.

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