January 20, 2020

Via e-mail to regs.comments@occ.treas.gov; comments@fdic.gov

The Honorable Joseph Otting
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: OCC Notice of Proposed Rulemaking (Docket ID OCC-2019-0027); FDIC Notice of Proposed Rulemaking (RIN 3064–AF21)

Dear Comptroller Otting and Chairman McWilliams,

The Milken Institute Center for Financial Markets appreciates the opportunity to provide comments on the separate notices of proposed rulemaking by the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC).[1] The proposed rules, which amend section 27 and 24(j) of the Federal Deposit Insurance (FDI) Act and section 85 and section 1463(g) of the National Bank Act, provide welcome clarity around the validity and enforceability of interest rate terms on loans that are sold, assigned, or otherwise transferred by national banks, federal savings associations, and state banks to non-banks.

The Milken Institute is a nonprofit, nonpartisan think tank that helps people build meaningful lives in which they can experience health and well-being, pursue effective education and gainful employment, and access the resources required to create ever-expanding opportunities for themselves and their broader communities. The Milken Institute Center for Financial Markets (CFM)[2] promotes financial market understanding and works to expand access to capital, strengthen and deepen financial markets, and develop innovative financial solutions to the most pressing global challenges.

Since the United States Court of Appeals for the Second Circuit's decision in *Madden vs. Midland*[3] *(Madden)*, the Milken Institute has consistently voiced its concerns about the decision[4] and potential negative repercussions from the lawsuit that extend well beyond the Second Circuit Court's jurisdiction.[5]

---

[1] OCC notice of proposed rulemaking (RIN 1557–AE73) https://www.occ.treas.gov/news-issuances/federal-register/2019/84fr64229.pdf; FDIC notice of proposed rulemaking (RIN 3064–AF21) https://www.fdic.gov/news/board/2019/2019-11-19-notice-dis-c-fr.pdf.

[2] "About Us – Center for Financial Markets," Milken Institute, https://milkeninstitute.org/centers/center-for-financial-markets.

[3] Madden v. Midland Funding, LLC, No. 7:11-cv-08149 (2d Cir. 2015) https://www.scotusblog.com/wp-content/uploads/2016/03/14-2131-2015-05-22.pdf.

[4] Brian Knight, "Congress Should Act to Preserve Financial Innovation," *Roll Call*, September 1, 2015, http://www.rollcall.com/beltway-insiders/congress-should-act-to-preserve-financial-innovation-commentary/?dcz=; Brian Knight, "Is This Any Way To Run a Railroad?," Milken Institute, February 29, 2016, https://milkeninstitute.org/center-for-financial-markets/articles/any-way-run-railroad.

[5] Connecticut, New York, and Vermont.

The two separate notices of proposed rulemaking come approximately two months after members of the US House Committee on Financial Services sent a letter to the OCC[6] urging the agency to address the uncertainty caused by the *Madden* decision, and nearly a year and a half after the US Department of Treasury, in its fourth and final report on core principles for regulating the US financial system, suggested federal banking regulators use their available authorities to address the challenges posed by *Madden*.[7]

We commend the OCC and FDIC efforts to address the concerns emanating from the Second Circuit Court's decision in *Madden*. Both notices of proposed rulemaking provide substantive legal histories behind the "valid when made" doctrine, including how the courts and the regulatory agencies have interpreted the legal doctrine over the years. In light of the uncertainty caused by the *Madden* decision, the proposed rules reaffirm long-standing views regarding the enforceability of interest rate terms on loans that are sold, transferred, or otherwise assigned.

While regulatory action to address the uncertainty caused by *Madden* is welcome, we are concerned that even if the OCC and FDIC adopt the rules as proposed, legal uncertainty will remain because the *Madden* decision still stands.[8] Unless the Second Circuit Court of Appeals reverses its decision in *Madden*, or the Supreme Court of the United States gets involved[9], we remain convinced that congressional action is the only way to address the negative consequences of the *Madden* decision.[10]

We believe there are three reasons why Congress should pass legislation that would reaffirm longstanding legal precedent called into question by the *Madden* decision:[11]

---

[6] Letter to US Comptroller of the Currency Joseph Otting regarding the legal doctrine of "valid when made", September 19, 2019, https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2019/09/Letter-to-Otting.pdf.

[7] "Treasury Releases Report on Nonbank Financials, Fintech, and Innovation," US Department of the Treasury, July 31, 2018, https://home.treasury.gov/news/press-releases/sm447.

[8] For example, in *Petersen v. Chase Card Funding LLC et al.,* plaintiffs, in their supplemental memorandum of law in opposition to defendant's motion to dismiss, state that the OCC's Notice of Proposed Rulemaking "is not rulemaking in any normal sense, but instead trying to simply hand the industry it regulates the judicial ruling that they could not obtain from the Supreme Court. The OCC has no such power and should not be afforded that power by this Court....The OCC's proposed rule, which rests on the same weak arguments and theories that are offered by Defendants – and which were unpersuasive to the Second Circuit in *Madden* – should be afforded no deference whatsoever." Available at: https://www.law360.com/articles/1232865/attachments/0 (pg. 6).

[9] On May 24, 2016, the Office of the Solicitor General of the United States filed a brief expressing the views of the United States and found that the Second Circuit's decision in *Madden* was "incorrect" and "reflects a misunderstanding of section 85 and of this Court's precedents." The Solicitor General also wrote that a national bank's "federal right to charge interest up to the rate allowed by section 85 would be significantly impaired if the national bank's assignee could not continue to charge that rate. Under the long-established 'valid-when-made' rule, if the interest rate term in a bank's original loan agreement was non-usurious, the loan does not become usurious upon assignment, and so the assignee may lawfully charge interest at the original rate." Despite disagreeing with the Second Circuit's decision, the US Solicitor General found that further review by the US Supreme Court was not warranted. The opinion of the US Solicitor General can be viewed here: https://www.scotusblog.com/wp-content/uploads/2016/06/midland.invite.18.pdf.

[10] Jackson Mueller, "Bipartisan Opportunities to Legislate U.S. FinTech in the 21st Century" (Milken Institute, March 2018), https://milkeninstitute.org/reports/bipartisan-opportunities-legislate-us-fintech-21st-century.

[11] In the following, we do not focus on the *Madden* decision itself, why the decision is unprecedented, or the legal history surrounding "valid when made," as this has been closely scrutinized and discussed in numerous legal advisories, regulatory notices and filings, including the current proposed rules, and in prior academic research.

1. **Theoretical predictions about the potential negative impact from *Madden* on high-risk borrowers and the secondary credit market are supported by mounting empirical evidence.**

In 2016, an academic study published in the *Columbia Law Review*[12] focused on the potentially deleterious effects of *Madden* on credit availability and the pricing of instruments tied to debt originated by a national bank in the secondary credit market. According to the study, the ruling in *Madden* could effectively:

- Set a new, lower-risk threshold above which national banks will be unwilling to extend credit, which could limit national banks' ability to extend credit to high-risk borrowers.
- Increase the difficulty of assessing the enforceability of individual loans, which may further depress potential buyers' demand for loans on the secondary market. The resulting higher transaction costs on the ability of national banks to set interest rates will not just be limited to high-risk borrowers, but also low-risk borrowers as banks bundle together different risk profiles to sell off the debt through securitization. As a result, both types of borrowers could experience a decrease in the availability of credit and a rise in the cost of borrowing.
- Force investors to reassess the risk of unenforceability for the tranches of loan contracts they own, thereby leading to profound price corrections throughout the secondary credit market.
- Eviscerate the peer-to-peer (P2P) lending market as Madden casts doubt on the ability of P2P lenders to reference the laws of only one state to determine the legality of their loans.
- Create a competitive disadvantage for P2P lending platforms due to the heightened operating costs of ensuring compliance with different usury laws across the US, ultimately resulting in the reduced availability of credit.

Subsequent empirical research has confirmed several of these possibilities.

In August 2017, three law professors published a study on the impact on consumer lending from the decision by the Second Circuit Court of Appeals.[13] The study used proprietary data from three marketplace lending platforms[14] and found that the decision in *Madden* not only reduced

---

Instead, we focus on *Madden's* actual impact to consumers in the Second Circuit, potential expansion of the *Madden* decision beyond the Second Circuit, and the political debates surrounding "valid when made" on Capitol Hill.

[12] Michael Marvin, "Interest Exportation and Preemption: *Madden*'s Impact on National Banks, the Secondary Credit Market, and P2P Lending," *Columbia Law Review*, Vol. 116 (January 15, 2016), https://ssrn.com/abstract=2753899.

[13] Colleen Honigsberg, Robert J. Jackson Jr., and Richard Squire, "How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment," *The Journal of Law and Economics* 60, no. 4 (November 2017): 673-712. Available at: https://www.journals.uchicago.edu/doi/abs/10.1086/695808.

[14] According to the study, the authors note that all three platforms "are among the largest–if not the largest–marketplace-lending platforms in the United States (Federal Reserve Board 2014)." The primary lending dataset contained data on roughly 950,000 loans provided by the three platforms, with a total principle amount of $12 billion. The study also included a secondary-market dataset of more than 1.3 million trades provided by two of the three platforms, in sizes ranging from $25 to $12,000. The authors analyzed only the trading of notes backed by individual loans, not bundled loans. (pgs. 18-20).

credit availability for higher-risk borrowers in the Second Circuit's jurisdiction[15] but affected the pricing of certain notes in the secondary market. Table 1 presents some key findings from the study.

Table 1: Findings from Honigsberg, Jackson Jr., and Squire (2017):

<table>
<tr><th colspan="2">Following Madden</th></tr>
<tr><th>Access to Capital[16]</th><th>Pricing of Notes in the Secondary Market</th></tr>
<tr><td>▪ Above-usury rate loans issued in the Second Circuit Court's jurisdiction vs. outside the jurisdiction: +65 percent vs. +125 percent.
▪ At/below-usury rate loans issued in the Second Circuit Court's jurisdiction vs. outside the jurisdiction: +97 percent vs. +95 percent.
▪ The growth rate for loans issued to borrowers with FICO credit scores below 625 in the Second Circuit Court's jurisdiction vs. outside the jurisdiction: -52 percent vs. +124 percent.
▪ The average loan size fell roughly $400 more than expected in Connecticut and New York, with the decrease in loan size especially felt among lower-quality borrowers.</td><td>▪ For notes backed by non-current loans,[17] the spreads were higher than expected. The mean and median spreads were 2.35 and 1.29, respectively.[18]
▪ For notes backed by current loans,[19] the magnitude of the spreads was much lower. The mean and median spreads were -0.018 and -0.0158, respectively.</td></tr>
</table>

The Honigsberg, Jackson Jr., and Squire (2017) study became a focal point during debates in the 115th Congress over H.R.3299, the *Protecting Consumers' Access to Credit Act of 2017*.[20]

---

[15] The Second Circuit Court's jurisdiction is Connecticut, New York, and Vermont. In the study, however, the professors focus on Connecticut and New York as the treatment group. "While usurious loans are void in Connecticut and New York, they remain valid in Vermont, where the borrower is excused only from paying interest above the permissible rate, and in a lawsuit against the lender can recover any such interest already paid, interest thereon, and reasonable attorney's fees. Because the laws of the three states award very different damages, we are hesitant to group these states for empirical purposes. Hence, we use only Connecticut and New York in our treatment group, and our Vermont loans are dropped from the tests. As a practical matter, including Vermont makes very little difference in our results, as we have relatively few observations in that state." (pg. 16-17)

[16] It is important to note that the authors only looked at loans issued through three marketplace lending platforms and, thus, do not rule out the possibility that borrowers substituted into other, potentially more costly sources of credit (e.g., credit cards).

[17] According to the authors, roughly seven percent of the trades in the dataset are for notes backed by non-current loans.

[18] While the deviation between notes backed by non-current loans in Connecticut and New York compared to outside the Second Circuit Court's jurisdiction widened significantly after the *Madden* decision, it took several months for the decision to have its full impact on markets.

[19] According to the authors, roughly 93 percent of trades in the dataset are for notes backed by current loans.

[20] H.R.3299, *Protecting Consumers' Access to Credit Act of 2017* (Introduced: July 19, 2017), https://www.congress.gov/115/bills/hr3299/BILLS-115hr3299rfs.pdf.

Supporters of this "*Madden*-fix" bill[21] used the study to buttress their claims that the *Madden* decision negatively affected the most vulnerable segments of society. Opponents argued that the study should be dismissed because its claims could not be reviewed due to the proprietary nature of the data used in the analysis.[22]

Since those debates, a second academic study has emerged that further highlights the negative consequences of the *Madden* decision. A 2018 study[23] by two professors found a contraction in lending, particularly to low-income borrowers, and a rise in personal bankruptcies following the *Madden* decision.[24] Table 2 presents some key findings from the study:

---

[21] Rachel Witkowski, "Legislation Proposed to Counteract Court Ruling on State Usury Caps," *The Wall Street Journal*, July 11, 2016, https://www.wsj.com/articles/legislation-proposed-to-counteract-court-ruling-on-state-usury-caps-1468278817.

[22] During the debates in the 115th Congress, Republicans latched onto the study to reinforce their arguments in support of the bill's passage. However, because the study was the only academic study to have been published on the Second Circuit Court's decision at that time, Democrats attempted to downplay the significance of it. In the House Floor debate, Rep. Maxine Waters (D-CA) said, "Those claims have not been substantiated. The only purported evidence we have on the effect of the *Madden* rule is a single, unpublished study that cannot even be peer reviewed because it relies on private data from a single, unidentified marketplace lender. And the authors of this study have not endorsed this bill."

[23] Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy," July 5, 2018. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208908.

[24] Like the prior study, the authors use Connecticut and New York as the treatment group, given the different treatment applied to above-usury loans to borrowers in Vermont. Lending data was supplied by Lending Club and Prosper – two leading marketplace platforms in the US. Data on the annual volume of consumer lending in each state, segmented by different types of consumer lending, was supplied by the New York Federal Reserve Center for Microeconomic Data. Bankruptcy filing data was obtained from the Administrative Office of the US Courts. In some cases, bankruptcy filings and marketplace lending data were supplemented with monthly US Bureau of Labor Statistics unemployment rates and labor force data. The final sample includes 2,700 observations from 45 states from January 2013 to December 2017. The study also found that the volume of lending by banks and other non-banks, not including marketplace lenders, is unaffected by *Madden*. "This formally confirms…that the increase in bankruptcy rates following *Madden* arises predominately from changes in marketplace lending." The study further finds that the effect of *Madden* on precipitating bankruptcy is "robust" and rules out the possibility that the increase in personal bankruptcies arises from borrowers switching to more expensive credit, such as payday loans. In addition, and similar to the prior study, the authors also rule out the possibility that the increase in personal bankruptcy was driven by an increase in defaults by marketplace borrowers in Connecticut and New York. (pg. 4)

Table 2: Findings from Danisewicz and Elard (2018)[25]:

<table>
<tr><th colspan="2">Following Madden</th></tr>
<tr><th>Access to Capital</th><th>Bankruptcy Cases[26]</th></tr>
<tr><td>Marketplace lending volume declined in Connecticut and New York between 10 percent and 14.6 percent.
For the riskiest borrowers, lending volume decreased between 28 percent and 82 percent. For certain credit-worthy borrowers, lending volume increased slightly.
Total lending volume for debt financing, paying medical bills, and personal business loans declined 10 percent in New York and Connecticut.
Debt financing declined 15 percent, loans for medical procedures declined 68 percent, and personal business loans declined 33 percent.
Lending volume to borrowers in Connecticut and New York with an annual income of less than $25,000 declined 64 percent, relative to borrowers outside the Second Circuit Court’s jurisdiction. Borrowers with higher annual incomes saw little to no decline in lending volume.</td><td>Bankruptcy filings in Connecticut and New York increased 8 percent compared to states outside the jurisdiction of the Second Circuit.
Personal business bankruptcy filings increased 2.3 percent, while consumer bankruptcy filings increased by 7.6 percent.
Low-income households experienced the largest (8.5 percent) rise in personal bankruptcy filings.
Bankruptcy filings among the three lowest income brackets examined in the study increased by 8.5 percent, 7.3 percent, and 4.7 percent, respectively.</td></tr>
<tr><th colspan="2">Madden’s Intensification Over Time</th></tr>
<tr><td colspan="2">Marketplace lending volume dropped 7.3 percent in the short-term and 12.1 percent in the long-run.
Bankruptcy cases increased by 6.8 percent in the first 12 months after the Madden decision and by 9 percent thereafter.</td></tr>
</table>

Since the Second Circuit Court’s ruling, we have gone from mere predictions of *Madden*’s impact on credit availability and the secondary credit market to data-driven empirical analyses that show that the Second Circuit Court’s ruling has had a significantly negative impact on high-risk borrowers located in the Second Circuit and on the pricing of certain debt sold in the secondary market. To date, there is no in-depth empirical study that contradicts the findings of the two

[25] “The results hold across an array of econometric specifications, variable and treatment group definitions, as well as being robust to alternative clustering and bootstrapping of standard errors, and matched sampling. Importantly, we control for access to other forms of non-bank lending besides marketplace lending, such as payday loans, and the availability of other consumer credit, including credit card loans.” (pg. 5).

[26] The study covered the following types of bankruptcy filings in the Second Circuit: Chapter 7, Chapter 11, Chapter 12, and Chapter 13. To note, because Chapter 12 is classified as a business bankruptcy, the authors were not able to use it for non-business bankruptcies in the analysis. The study pays particular attention to Chapter 7 and Chapter 13 filings, since Chapter 11 filings are more complex, expensive, and are typically filed by wealthier households.

studies showing the harmful effects of the *Madden* decision on consumers and credit markets more broadly.

2. Madden-like cases are surfacing throughout the United States, further compounding legal uncertainty surrounding "valid when made."

Throughout the United States, litigation continues to surface that may extend the effects of *Madden* beyond the Second Circuit's jurisdiction, thereby increasing legal uncertainty (and cost) surrounding the sale, transfer, or assignment of loans by national banks, federal savings associations, and state banks to non-bank entities. We highlight three cases below.[27]

***Blyden v. Navient Corp.[28]*:** The plaintiff, Marlene Blyden, brought a class action lawsuit arguing that the sale of her student loan, originated by a national bank, to a non-bank entity violates California anti-usury law. The 10.25 percent interest rate on the loan was more than the interest rate allowed under California law (10 percent) for that particular credit product. Of particular interest is that the plaintiff named several investment trusts as defendants who had purchased loans from the bank, even though they had no interest in the specific loan itself.

As Patrick Siegfried noted in a blog post in *deBanked*,[29] the *Blyden* case "shows that a large number of unrelated entities may be drawn into extended litigation by a plaintiff that is unable (because of a lack of information) or unwilling (because of a desire to represent that largest class possible) to limit its claims to those specific entities that have had or presently maintain an interest in the loan at issue." Further, as Michael Marvin wrote in a submission to the *Columbia Law Review*,[30] the addition of defendants who may have never held an interest in the plaintiff's debt "indicates how vastly the new transaction costs *Madden* imposes impact a national bank's ability to sell off debt and, therefore, its ability to extend credit."

While the United States District Court for the Central District of California dismissed the complaint due to pleading deficiencies, the Court did grant the plaintiff leave to amend her complaint.

Rent-Rite Super Kegs Ltd. v. World Business Lenders, LLC:[31] In the United States Bankruptcy Court for the District of Colorado, the plaintiff, Rent-Rite, sued World Business Lenders, arguing that the assignment of rights under the promissory note,[32] executed between a Wisconsin state-

---

[27] It is important to note that this is not an exhaustive list of cases. In addition, we have provided very brief descriptions for each of the following listed cases. Those interested in the full case description should review the actual cases themselves.
[28] *Blyden v. Navient Corp.,* No. 5:14-CV-2456, 2015 WL 4508069 (C.D. Ca. July 23, 2015).
[29] Patrick Siegfried, "Blyden v. Navient Corp: A Glimpse of a Post-Madden Future?", *deBanked*, July 28, 2015, https://debanked.com/2015/07/blyden-v-navient-corp-a-glimpse-of-a-post-madden-future/.
[30] Michael Marvin, "Interest Exportation and Preemption: *Madden*'s Impact on National Banks, the Secondary Credit Market, and P2P Lending," *Columbia Law Review*, Vol. 116 (January 15, 2016), https://ssrn.com/abstract=2753899.
[31] *Rent-Rite Superkegs West, Ltd., v. World Business Lenders, LLC*, 2019 WL 2179688 (US Bankr. Court D. Colo. May 2019).
[32] Under the executed promissory note, CMS Facilities Maintenance, Inc., a Colorado-based corporation, promised to repay the $550,000 loan originated from the Bank of Lake Mills, a Wisconsin state-chartered bank, at an annual interest rate of 120.86 percent. Both parties agreed that the promissory note would be governed by federal law and Wisconsin law (if not preempted).

chartered bank, Bank of Lake Mills, and CMS Facilities Maintenance, Inc., to World Business Lenders, LLC was usurious. The plaintiff, citing *Madden*, contended that the promissory note should be governed by Colorado law, which prohibits interest rates above 45 percent per annum, compared to the 120.86 percent annual rate that CMS Facilities Maintenance agreed to pay on the loan originated by the Bank of Lake Mills.

In its ruling that denied all claims brought by Rent-Rite, the court not only disagreed with the *Madden* decision,[33] but stated that the "[p]leas for fairness and equity cannot rescue the Debtor from the governing law, or its misguided decision-making."[34]

In an amicus brief submitted by the FDIC and OCC in support of the bankruptcy court's ruling, the two federal regulatory agencies had ample opportunity not only to discuss the current case but the deficiencies in the Second Circuit Court of Appeals decision in *Madden.* The agencies stated the following:

> *"Madden's disregard of two centuries of established law—without even addressing such law—is not just wrong: it is unfathomable. And it is doubly disconcerting given its negative impact on the credit markets and the banking system…Madden's idea that a bank is not prevented from assigning when its assignees are not allowed to enforce the transferred interest rate blinks reality: if the interest rate is not enforceable upon assignment, there is nothing for the bank to assign."*[35]

Cohen v. Capital One Funding, LLC, et al.:[36] In the first notable case filed covering securitization of debt originated by a national bank after the *Madden* ruling,[37] a group of Capital One credit card holders filed a class action lawsuit against several trusts and the trustees of those trusts arguing that the defendants violated New York anti-usury law by charging interest rates[38] above what is permissible.[39] The plaintiffs claimed that federal preemption of New York's anti-usury law was

---

[33] Memorandum Opinion and Order Denying All Claims, *Rent-Rite Superkegs West, Ltd., v. World Business Lenders, LLC*, 2019 WL 2179688 (US Bankr. Court D. Colo. May 2019). Available at:, https://www.docketbird.com/court-documents/Rent-Rite-Super-Kegs-West-LTD-v-World-Business-Lenders-LLC/Written-Opinion-related-document-s-43-Order-Dismissing-Adversary-Proceeding-lab-Document-terminated-Modified-on-5-20-2019-lab/cob-1:2018-ap-01099-00044. (Pg. 22)

[34] Memorandum Opinion and Order Denying All Claims, Memorandum Opinion and Order Denying All Claims, *Rent-Rite Superkegs West, Ltd., v. World Business Lenders, LLC*, 2019 WL 2179688 (US Bankr. Court D. Colo. May 2019). Available at: https://www.docketbird.com/court-documents/Rent-Rite-Super-Kegs-West-LTD-v-World-Business-Lenders-LLC/Written-Opinion-related-document-s-43-Order-Dismissing-Adversary-Proceeding-lab-Document-terminated-Modified-on-5-20-2019-lab/cob-1:2018-ap-01099-00044. (Pg. 2)

[35] Amicus Brief of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency in Support of Affirmance and Appellee, *Rent-Rite Superkegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-RBJ, US Dist. Court D. Colo. Sept. 2019). Available at: https://www.cadwalader.com/uploads/media/Amicus_Brief_of_the_FDIC_and_OCC.pdf (Pgs. 30-31)

[36] *Cohen v. Capital One Funding, LLC, et al.*, 19-cv-03479-KAM-RLM (E.D.N.Y.).

[37] New Type of Lawsuit Involving Securitized Debt: Citing *Madden*, Plaintiffs Contend that Credit Card Debt Became Subject to NY Usury Laws Once the Debt was Securitized, Sullivan & Cromwell, LLP, June 17, 2019, https://www.sullcrom.com/files/upload/SC-Publication-Lawsuit-Challenges-Federal-Preemption-Of-State-Usury-Laws-On-Securitized-Debt.pdf.

[38] According to the complaint, the plaintiffs are paying interest rates of at least 22.5 percent, 25.15 percent, 26.24 percent, and 27.74 percent on certain loans originated and sold by Capital One Bank, a national bank.

[39] New York maintains a civil usury rate of 16 percent and a criminal usury rate of 25 percent.

severed once the national bank sold the credit card receivables to the named special purpose entities in the lawsuit who then securitized those receivables. The complaint specifically relies on the decision in *Madden* to support plaintiffs' claims.

Here too, several individuals commented that the *Cohen* case actually contradicts one of the core findings in *Madden*: that because the parent company, in this case, Capital One, NA, continues to own the account relationship, this precludes the application of state usury law.[40] The defendants' motion to dismiss further echoes this point.[41]

While the United States District Court for the Eastern District of New York (located in the Second Circuit) has yet to rule on the case, a decision that affirms plaintiffs' claims could have a significant impact on the availability of capital, and deleterious effects on the secondary credit market.[42]

3. Political scrutiny conflates "valid when made" and "true lender" issues, further compounding legal uncertainty.

We commend the OCC and the FDIC for going to great lengths in specifying that their separate notices of proposed rulemaking do not focus on which entity is the real party of interest or has an economic interest in a loan. The "true lender" doctrine, as it is commonly known today, is outside the scope of the rulemaking, according to the OCC and FDIC.[43] We agree with this assessment.

While the "true lender" and "valid when made" doctrines are similar in that both concern the relationship between a regulated bank and a non-bank entity, the "true lender" doctrine is largely focused on which entity is the actual lender in the relationship. In contrast, the "valid when made" doctrine focuses on whether interest on a loan remains permissible once sold, assigned, or

---

[40] Walter Zalenski, "NY Credit Card Securitization Class Action Misuses Madden," *Law360*, July 18, 2019, https://www.law360.com/articles/1178023/ny-credit-card-securitization-class-action-misuses-madden.

[41] Meg Slachetka, "Capital One Affiliates Seek Dismissal of Usury Putative Class Action," *Capital Markets Litigation Blog,* Lowenstein Sandler, November 6, 2019, https://www.capitalmarketslitigation.com/2019/11/capital-one-affiliates-seek-dismissal-of-usury-putative-class-action/.

[42] A legal advisory from Sullivan & Cromwell, LLP suggests that if the *Cohen* lawsuit is successful, it would create a "strong disincentive for non-banks (including securitization trusts) to purchase debt or tranches of debt owed by borrowers within the Second Circuit"; would call into question "federal preemption of all state consumer laws – beyond just usury – that apply to debt owed by borrowers in the Second Circuit"; and would threaten "the origination of all debt – not just credit card debt – including mortgage loans." Separately, Walter Zalenski, a partner at Buckley LLP, states that the *Cohen* case, if successful, "casts a cloud not only over bank sales of charged-off credit card debt, but also over bank sales via securitizations or otherwise, of closed-end loans to borrowers in the Second Circuit states."

[43] OCC: "This rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party. The true lender issue, which has been considered by courts recently, is outside the scope of this rulemaking." Available at: https://www.occ.treas.gov/news-issuances/federal-register/2019/84fr64229.pdf. FDIC: "The regulations do not address the question of whether a state bank or insured branch of a foreign bank is a real party in interest with respect to a loan or has an economic interest in the loan under state law, e.g., which entity is the ''true lender.' Moreover, the FDIC supports the position that it will view unfavorably entities that partner with a state bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)." Available at: https://www.fdic.gov/news/board/2019/2019-11-19-notice-dis-c-fr.pdf.

transferred by a regulated bank to a non-bank entity. The Milken Institute previously wrote about the distinctions between the "valid when made" and "true lender" doctrines.[44]

Unfortunately, because of the relative similarity between the two legal doctrines, lawmakers continue to conflate the two issues. This has led to accusations that the FDIC and OCC proposals support "rent-a-bank" schemes, whereby payday lenders will benefit to the detriment of low-income borrowers.

As FDIC Chairman Jelena McWilliams repeatedly stated in two separate congressional oversight hearings in early December 2019,[45] such claims could not be further from the truth. During a Senate Banking Committee hearing, in response to a question from Senator Mike Crapo (R-ID) regarding FDIC's proposal to address the confusion around "valid when made" while maintaining safety and soundness, Chairman McWilliams said:

> *The FDIC's proposal basically does not change since the framework we had before Madden. Since 1828, there was a Supreme Court precedent that basically said if a loan is not usurious when made, nothing subsequently makes that loan usurious. This Congress gave the National Bank [Act] that privilege as well in 1865, and then 115 years later in 1980 [the FDIC] got the same opportunity to implement that into our statute. So we have had long, existing guidance implementing basically exactly that. It's the so-called Valid When Made Doctrine that the Court in Madden frankly ignored. They ignored almost 200 years of both regulatory and legal history. And so we were compelled to provide clarity restating what we have had in place for, since 1980, frankly at the FDIC. And our proposal does not change anything that we have had since 1980. The concern with Madden is that they're going to be implications for the secondary market that are frankly going to undermine the safety and stability of the system and the soundness of our banks. If banks are unable to sell loans in the secondary market and have the sanctity of the contract carryover, there's going to be disruption in the ability of the banks to basically be able to offload those loans if they need liquidity at a time of stress. And it's something that we from the Regulatory perspective are quite concerned about.* [46]

During a House Financial Services Committee hearing, in response to questions from Rep. Rashida Tlaib (D-MI) regarding so-called "rent-a-bank" schemes, efforts by payday lenders to take advantage of such schemes, and whether the proposal put forth by the FDIC supports this arrangement, Chairman McWilliams said:

> *So there has been a lot of confusion about what we did and what we didn't do, and I believe you're talking about the doctrine of so-called true lender which our proposal did not touch.*

---

[44] Jackson Mueller, "Bipartisan Opportunities to Legislate U.S. FinTech in the 21st Century" (Milken Institute, March 1, 2018), https://milkeninstitute.org/reports/bipartisan-opportunities-legislate-us-fintech-21st-century. (pgs. 25-31).

[45] "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions?" US House Committee on Financial Services, December 4, 2019, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404855; "Oversight of Financial Regulators", US Senate Committee on Banking, Housing, and Urban Affairs, December 5, 2019, https://www.banking.senate.gov/hearings/11/21/2019/oversight-of-financial-regulators.

[46] FDIC Chairman Jelena McWilliams response to a question posed by Senator Mike Crapo (R-ID) on how the FDIC's proposal addresses the confusion caused by the *Madden* decision. Available at: https://www.banking.senate.gov/hearings/11/21/2019/oversight-of-financial-regulators (00:41:11 - 00:43:05).

> *Our proposal, the only thing it did…is in fact address our long-standing principles that Congress gave us the authority to do in 1980, which is to say that when a loan is made, and the interest rates are not usurious at a time when the loan is made, no subsequent event makes those loans usurious – basically preserving the sanctity of a contract to ensure that there is a secondary market for the sale of these loans. States do have an opportunity to opt out of that regime. Congress, you gave them that authority in Section 27 of the FDI Act as well, and frankly we frown upon and we look disfavorably upon the schemes that you're talking about... The rent-a-bank schemes, what you're referring to as rent-a-bank, it's not a regulatory term. Those arrangements are provided under the so-called true lender doctrine which we didn't touch. It's up to States to decide what rate caps are appropriate, if any, and whether or not the states want to opt-out of the ability of the interest rates to be preserved when an out-of-state entity purchases that loan product. We did not touch that issue.*[47]

While we are supportive of the FDIC and OCC proposals to provide further regulatory clarity concerning the "valid when made" doctrine, these proposals cannot formally reverse the Second Circuit Court of Appeals' decision in *Madden.* Legal uncertainty regarding the enforceability of loans originated by national banks, federal savings associations, and state banks that are then sold, assigned, or transferred to a third party, will remain.

Unless the Second Circuit Court reconsiders its decision in *Madden*, or the Supreme Court of the United States gets involved, we continue to believe that the most effective way to address the negative financial impact to high-risk borrowers and the broader secondary credit market is for Congress to pass legislation designed to fix the *Madden* decision.

The Milken Institute appreciates the opportunity to comment on the separate notices of proposed rulemaking. We look forward to engaging further with OCC and FDIC staff on this letter and these issues.

Sincerely,

Jackson Mueller
Associate Director, FinTech Program
Milken Institute Center for Financial Markets

---

[47] FDIC Chairman Jelena McWilliams response to questions posed by Rep. Rashida Tlaib (D-MI) concerning the "true lender doctrine". Available at: https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404855 (2:07:10 - 2:12:20).