Court Upholds "Valid When Made" Rules, But "True Lender" Risk Lives On

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In a victory for fintechs and the banks that partner with them, the U.S. District Court for the Northern District of California recently turned back two challenges by a consortium of state attorneys general to the "valid when made" regulations issued in 2020 by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). Under the rules and the "valid when made" doctrine, the interest rate on a bank-made loan remains valid and enforceable even after the bank sells or transfers it to a party that could not have originated the loan on the same terms as the bank.

In their challenges, the states, which included California, Illinois and New York in the lawsuit against the OCC, and California, Illinois, Minnesota, New Jersey, New York, North Carolina, Massachusetts and the District of Columbia in the lawsuit against the FDIC, argued that both agencies violated the Administrative Procedure Act by issuing the rules that they alleged (1) exceeded their authority, (2) were arbitrary and capricious and (3) violated other federal rulemaking standards. The court ruled that both the OCC and FDIC acted within their authority and that their actions were a reasonable (and thus permissible) construction of their authorizing statutes.

The rulings upholding the regulations solidify the repudiation of the decision in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). In *Madden*, the U.S. Court of Appeals for the Second Circuit – which includes Connecticut, New York and Vermont – held that non-national bank entities that purchase loans originated by national banks cannot rely on the National Bank Act to protect them from state-law usury claims. The *Madden* decision contradicted decades of jurisprudence that held that one determines whether a loan is usurious by examining the authority of the lender that originated the loan. If a loan complied with usury limitations at origination, it cannot become usurious simply because another party purchased the loan. The *Madden* decision injected tremendous uncertainty into the national credit market that the OCC and FDIC rules intended to correct.

Although the decisions are welcomed by participants in the bank partnership credit market, they are not the final word on bank partnerships. Shortly after the decisions, Acting Comptroller of the Currency Michael J. Hsu issued a statement at once welcoming the "legal certainty" but also warning that such clarity should be "used to the benefit of consumers" and not "as a vehicle for 'rent-a-charter' arrangements."

The decisions will likely serve as a meaningful deterrent against consumer lawsuits alleging a *Madden* claim that challenge the interest rates on bank-made loans as violating state usury laws.

The rules, now affirmed by a federal court, provide that the interest rate on transferred loans is not subject to attack under state usury laws if the interest rate was permissible at the time of origination. The decisions will not, however, deter other theories challenging bank partnerships, including the allegation that the bank in such partnerships is not the "true lender." One of the challengers to the rules, the District of Columbia, has already sued fintechs that partnered with banks to offer loans in excess of the District's usury cap, claiming that the fintechs, not the bank, were the true lender.

Although it is not clear whether the states will appeal the rulings (they have until April 11 to do so), the U.S. Court of Appeals for the Ninth Circuit has already suggested in another case – *McShannock v. JP Morgan Chase Bank NA*, 976 F.3d 881, 892 (9th Cir. 2020) – that *Madden* was wrongly decided, and noted that lenders in the wake of *Madden* issued smaller and fewer loans.