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States challenge FDIC 'valid when made' rule with new lawsuit

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On August 20, 2020, seven states — California, Illinois, Massachusetts, Minnesota, New Jersey, New York, and North Carolina — and the District of Columbia (together, the States) filed suit[1] against the Federal Deposit Insurance Corporation (FDIC) in the U.S. District Court for the Northern District of California. The lawsuit, captioned *People of the State of California, et al. v. FDIC*, Case No. 20-CV-5860, challenges the FDIC's Rule on the "valid when made" doctrine.

As LenderLaw Watch has previously reported,[2] the FDIC and Office of the Comptroller of the Currency (OCC) recently issued rules affirming the "valid when made" doctrine, clarifying that the determination of whether interest on a loan is permissible is determined when the loan is made and that a bank's transfer of a loan to a third party does not impact the validity or enforceability of that interest.

The States argue that they, like many states, impose maximum interest rate caps to prevent lenders from charging excessive rates on consumer loans, which are intended to protect consumers from excessive interest rates that make it difficult for consumers to repay loans.

The FDIC's rule is 12 C.F.R. § 331.4(e), and provides that "[w]hether interest on a loan is permissible under [the Federal Deposit Insurance Act] is determined as of the date the loan was made" and "[i]nterest on a loan ... shall not be affected by a change in State law, a change in the relevant commercial paper rate after the loan was made, or the sale, assignment, or other transfer of the loan, in whole or in part."

A smaller group of states (California, Illinois, and New York) filed suit against the OCC in July 2020, challenging the OCC's "valid when made" rule. As LenderLaw Watch reported,[3] in that separate lawsuit, the states contend that the OCC's issuance of the rule violated the Administrative Procedures Act (APA) in that the OCC rule is (i) arbitrary and capricious, (ii) in excess of its statutory authority, and (iii) an agency action taken without observance of procedure required by law.

The more recent lawsuit filed against the FDIC likewise alleges that the agency's "valid when made" rule violates the APA, and makes many of the same arguments as were made in the OCC lawsuit.

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The States argue that, "in practice," the FDIC rule "will facilitate evasion of state law by enabling 'rent-a-bank' schemes, in which banks, not subject to interest-rate caps, act as a mere pass-through for loans that, in substance, are issued by non-bank lenders."

The States reiterate many of the arguments raised in the OCC lawsuit. The primary difference between the two lawsuits is that the FDIC lawsuit asserts that the FDIC rule is contrary to the plain language and statutory scheme of 12 U.S.C. § 1831 (Section 27 of the Federal Deposit Insurance Act), which preempts state interest-rate caps as applied to FDIC Banks (and no other entities, such as the assignees, transferees, or purchasers of loans originated by FDIC Banks).

The States argue that the FDIC's new rule impermissibly extends this preemption to non-FDIC Banks.

Much of the States' complaint echoes the OCC arguments: for example, the States assert that the FDIC's rule is an impermissible attempt to overturn the Second Circuit decision, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), which it lacks the authority to do, and that the FDIC failed to meaningfully consider the rule's inevitable facilitation of predatory "rent-a-bank" schemes by permitting lenders to evade state law by partnering with national banks.

The FDIC and OCC rules were intended to address the ambiguities surrounding the "valid when made" principle that the Second Circuit highlighted in *Madden*.

The latest FDIC lawsuit — much like the lawsuit filed weeks ago against the OCC — means that the confusion surrounding this issue persists. Both agencies are expected to vigorously defend their "valid when made" rules, and the outcome of these lawsuits will significantly impact the secondary market for loans originated by national banks.

Notes

[1] https://on.ny.gov/2RR2h1V

[2] https://bit.ly/32RJBFA

[3] https://bit.ly/2FKzQ3q

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