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Secondary Loan Markets Post-Madden: Overcoming Restrictions in Future Loan Transactions and Secondary Market Sales

Strategies for Banks, Marketplace Lenders and Other Debt Purchasers to Effect Secondary Market Transactions

TUESDAY, NOVEMBER 1, 2016

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Secondary Loan Markets Post-Madden: Solving Secondary Market Sales and Liquidity Issues

Strategies for Banks, Marketplace Lenders and Other Debt Purchasers

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November 1, 2016

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Agenda

I. Statutory and Regulatory Summary
II. Second Circuit Decision in *Madden*
III. Valid When Made Doctrine
IV. Marketplace Lending – True Lender and Rent a Charter Challenges
V. Other Litigation Prompted by Madden
VI. Future of the Secondary Markets Post-*Madden* and Effects on Secondary and Securitization Participants
VII. Loan Sales After *Madden*

Appendix 1 – Bank Powers, Interest Rates and Loan Sales – Applicable Statutes and Regulations

Appendix 2 – Clearing House Association, SIFMA, and American Bankers Association Amicus Briefs

I. Statutory and Regulatory Summary

Statutory and Regulatory Summary

- 12 U.S.C. 24(7) – National bank incidental powers include loan sales
- 12 U.S.C. 85 and 86 – Usury and interest rate preemption
- Federal Deposit Insurance Act Section 27
  - State chartered banks and foreign insured branches usury and interest rate preemption
- OCC Regs. § 7.4001 – Charging interest rates, etc.
- OCC Regs. § 7.4008 – Lending by national banks – authority of national banks

Statutory and Regulatory Summary

- National Bank Powers
  - Dodd-Frank Act Section 1044 preserves interest rate preemption
  - Volcker Rule, BHC Act Section 13(g) does not restrict loan sales or securitizations

- Fair Debt Collection Practices Act
  - 15 U.S.C. 1692(e) – no false misrepresentations
  - 15 U.S.C. 1692(f) – no unfair collection methods or collection of amounts not provided by contract and permitted by law.

II. Second Circuit Decision in *Madden*

Second Circuit Decision in Madden (cont'd)

Facts

- Credit card agreement originated by Bank of America, N.A. and assigned to its national bank affiliate, FIA Card Services, N.A. ("FIA")
- FIA charged-off all of Madden's debt before selling it to Midland Funding
- Parties stipulated that Madden had received the Cardholder Agreement and Change of Terms upon the FIA assignment, and that FIA had assigned the Madden account and debt to Midland Funding, a non-bank
- FIA retained no interest in the Madden account sold to Midland Funding
- Midland Funding, 2 years after the debt was purchased, sent Madden a collection letter stating that interest on the debt was 27%, which was a permissible rate under the Cardholder Agreement and Delaware law, which governed such Agreement
- The 27% rate exceeded New York's usury limitation

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Second Circuit Decision in Madden

Madden's Appellate Claims

- Usury. National Bank Act did not preempt state usury claims
  - Second Circuit agreed
  - Remanded the governing usury law question to the District Court

- Fair Debt Collections Practices Act. By attempting to collect interest at a rate higher than New York law permitted, the defendants falsely represented the amounts that Madden owed
  - Applicable state's (Del. or N.Y.) usury law issue remained open
  - Midland Funding was not entitled to National Bank Act preemption

Second Circuit Decision in Madden (cont'd)

Key Points from Madden Second Circuit Decision

- Interest Rate Preemption
  - 12 U.S.C. 85 allows national banks to charge interest based on state law where the bank is "located" and 12 U.S.C. 86 provides the exclusive cause of action for usury claims against national banks. Beneficial Nat'l Bank v. Anderson, 539 U.S. 1 (2003).
  - Consistent with 12 U.S.C. 85, assignees from a National Bank can charge interest based on the law of the state where the assignor bank is located.
    - The Second Circuit stated that, as to action by a non-national bank, "application of the state law to that action must significantly interfere with a national bank's ability to exercise its power under the National Bank Act. Barnett Bank of Marion Cnty., N.A. v. Nelson, 517 U.S. 25 (1996) ("Barnett"); Pac. Capital Bank, N.A. v. Connecticut, 543 F.2d 341 (2d Cir. 2008) ("Pacific Capital Bank")

Second Circuit Decision in Madden (cont'd)

- Agents of national banks can benefit from national bank preemption. Pacific Capital Bank and SPGGC, LLC v. Ayotte, 488 F.2d 525 (1st Cir. 2007) (Bank may use its duly authorized officers and agents to exercise its incidental powers).

Second Circuit Decision in Madden (cont'd)

- Midland Funding argued that as an assignee of a national bank, it was allowed to charge interest at the state rate where the assignor national bank is located (i.e. Delaware; not New York)
  - OCC Bull. 2014-37 Risk Management Guidance (Aug. 4, 2014) makes it "clear that third party debt buyers are distinct from agents or subsidiaries of a national bank."
  - The debt buyers have only acted on their own behalf, and are not agents of the originating bank.
  - Although governing usury law was not determined, the Second Circuit reasoned that applying state usury law to third-party debt buyers would not significantly interfere with the selling national bank's exercise of National Bank Act powers under Barnett since these state laws would not prevent national bank sales of consumer debt

Second Circuit Decision in Madden (cont'd)

- Since the originating national bank retained no interest in the sold accounts, the buyer could not be an agent of or acting on behalf of the seller national bank. This was contrasted with Krispin v. May Department Stores, 2318 F.3d 919 (8th Cir. 2000) ("Krispin") where the national bank maintained an interest in sold accounts.

Second Circuit Decision in Madden (cont'd)

OCC Positions

•The Solicitor General and the OCC submitted an amicus curiae brief dated May 24, 2016 to the Supreme Court in connection with the appeal of the Madden Second Circuit decision.

•"Valid when made" doctrine

": . . a loan contract that is valid when it was made 'can never be invalidated by any usurious transaction.'" Krispin quoting Nichols v. Fearson, 32 U.S. (7 Pet.) 103 (1833)

○Gaither v. Farmers & Mechs. Bank of Georgetown, 26 U.S. (1 Pet.) 37, 43 (1828) ("[T]he rule cannot be doubted, that if the note be free from usury, in its origin, no subsequent usurious transactions respecting it, can affect it with the taint of usury."). The power explicitly conferred on national banks by Section 85—i.e., the power to originate loans at the maximum interest rate allowed by the national bank's home State—therefore carries with it the power to use the loans once originated for their usual commercial purposes, which include assignment of such loans to others.

Second Circuit Decision in Madden (cont'd)

- Section 85 "encompasses the power to convey to an assignee the right to enforce the interest rate term of the agreement, including to an entity other than a national bank."

- "A national bank's power to charge the interest rate authorized by Section 85 includes the power to transfer a loan, including the agreed-upon interest-rate term, to an entity other than a national bank. When Congress enacted Section 85's earliest statutory antecedent, it was already established that a bank's power to sell loans was a "necessarily implied" corollary of the power to originate loans. Planters' Bank of Miss. v. Sharp, 47 U.S. (6 How.) 301, 322 (1848) (holding that state law that barred state bank from transferring a loan violates the constitutional prohibition on state impairment of contracts, U.S. Const. Art. I, § 10, Cl. 1). As this Court has recognized, "in discounting notes and managing its property in legitimate banking business, [a bank] must be able to assign or sell those notes." *Id.* at 323; see id. at 321-325. "

Second Circuit Decision in Madden (cont'd)

- Respondent's state-law usury claim is preempted by Section 85 because it directly interferes with a national bank's authority to make and transfer loans at the permitted rate of interest. The credit-card debt at issue in this case was originated by FIA, a national bank that is located in Delaware. FIA's contract with respondent specified a 27% rate of interest, which the parties agree was permissible under Delaware law....

- Application of state usury law here [to change the original contract rate entered into by the originating bank] would "prevent or significantly interfere with the national bank's exercise of [those] powers," *Barnett Bank*, 517 U.S. at 33, and it therefore is preempted.

- And, in the aggregate, the marketability (and therefore the value) of a national bank's loan portfolio could be significantly diminished if the national bank could not transfer to assignees the right to charge the same rate of interest that the national bank itself could charge.

Second Circuit Decision in Madden (cont'd)

- ... the practical importance of the pre-emption issue presented in this case depends significantly on the extent to which individual States decline to incorporate the valid-when-made rule into their own usury laws. Petitioners have made no effort to demonstrate that state law departures from the valid-when-made rule have been widespread. For this reason as well, the Court's review is not warranted at the present time.

Second Circuit Decision in Madden (cont'd)

- OCC Interpretative Letter 782 (June 1997)
  - The OCC general counsel discussed where a national bank is "located" for purposes of 12 U.S.C. 85.

- "As the OCC previously has recognized, for purposes of section 85, a national bank is "located" in any state in which it has its main office or a branch office. See OCC Interpretive Letter No. 686, September 11, 1995, reprinted in [1995-96 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-001. Having determined that a bank may be located in more than one state for purposes of section 85, the OCC then addressed the question of whether the particular bank could charge interest under the law of a particular state in which it had a branch with respect to certain loans made by the bank to residents of various states."

II. Second Circuit Decision in Madden (cont'd)

- "While the courts never have specifically addressed the issue of whether a national bank is considered, for purposes of section 85, to be located in a state or states in which it operates branches, based on precedents construing 12 U.S.C. §§ 36 and 94 (respectively, section 36 and section 94), the OCC determined that, for purposes of section 85, a national bank is considered to be located in states in which it maintains branches.[10] Notably, the Court in Marquette, citing Bank of California and Bougas, recognized that a bank could be considered to be located in a state in which it has a branch...."

10 See Interpretive Letter 686 reaffirmed in Interpretive Letters 707 and 782 (relying on Seattle Trust & Savings Bank v. Bank of California, N.A., 492 F.2d 48, 51 (9th Cir.), cert. denied, 419 U.S. 844 (1974)) (Bank of California) (under 12 U.S.C. § 36(c), an interstate national bank with grandfathered branches in a state other than its home state is "situated" in the state of the grandfathered branches for purposes of establishing additional branches in that state).

III. Valid When Made Doctrine

Valid When Made Doctrine

- Longstanding doctrine dating to 1833 Supreme Court Case

- Section 85 of the National Bank Act (12 U.S.C. 85) permits national banks to change an interest rate that is permissible in "the State, Territory or District where the banks is located. . . ."

- If the loan's governing law provided an interest-rate permissible in a state where the bank is located, the loan does not become usurious upon assignment, and the assignee may lawfully charge interest at the original rate

Valid When Made Doctrine

- Example of the Valid When Made Doctrine
  - National Bank originates loan with interest rate of 27%
    - Rate is permitted in state where bank is located, and whose law is chosen to govern
  - Loan is sold to another person located in another state that prohibits interest rates above 25%
  - The buyer (bank or non bank) may enforce the loan at 27% interest without violating state usury law

Valid When Made Doctrine

- But *Madden* goes the other way
  - BoA/FIA originated a credit card account governed by Delaware law and provided interest permissible under Delaware law
  - Midland purchases the account, and attempts to collect interest at rate permitted under Delaware law
  - Madden sues under New York law because Midland, the buyer of the receivables, charged interest in excess of New York usury law
- *Madden* is inconsistent with the Valid When Made Doctrine

IV. Marketplace Lending – True Lender and Rent a Charter Challenges

Pre-*Madden* Regime for Marketplace Lending

- Two models for marketplace lending
  - Direct lending: marketplace lenders originate own loans
  - Bank partnerships: marketplace lenders enter contractual relationships with FDIC-insured banks
    - Banks originate the loan, and the marketplace lender purchases loan from bank

- Advantages of partnership
  - The named lender is the Bank
  - Assumes that the bank can export rates and terms from any state where the bank is “located”

Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015)- Contrasts to earlier cases

- *Krispin v. May Department Stores*, 218 F.3d 919 (8th Cir. 2000)
  - Non-national bank entity issued credit card accounts and assigned these to a national bank
  - Non-national bank then purchased receivables from national bank
  - The national bank was a wholly-owned subsidiary of the non-national bank entity.

- *Madden*: *Krispin* national bank retained substantial interest in accounts
  - The non-bank purchases of the receivables did not change the fact that the bank retained ownership of the accounts due to the close relationship between the national bank and its parent.

Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015)- Contrasts to earlier cases

- *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2006)
  - National bank charged allegedly unlawful fees on mortgage loans
    - Including a purported "finder's fee" to a non-bank entity
  - Bank then sold loans to other defendants

- *Madden*: originating entity charged the interest
  - NBA preemption applied because the bank charged interest
  - Midland increased interest rate in *Madden*

Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015)- Contrasts to earlier cases

- *Madden* limited ability of non-bank entity to export interest rates
  - Midland not permitted to raise NBA preemption as a defense merely because national bank originated debt
  - National bank must retain substantial interest in the debt

- Cases where *Madden* does not apply
  - Non-bank acting as agent of bank
  - Effect of state law: interfere with bank powers

Marketplace Lending -True Lender and Rent a Charter Challenges

- Who is the “true lender” in banking “partnerships” where a non-bank is involved in making the loan, but the bank is identified as lender on the loan?
  - The bank immediately or shortly after origination sells the loan to its non-bank “partner” or as directed by the non-bank partner
  - The “partnership” may be attacked on the theory that the bank is not the “true” lender and that the bank is a “sham” lender that permits the non-bank lender, which is the “true lender,” to avoid state interest rate laws

Marketplace Lending -True Lender and Rent a Charter Challenges

- Approaches to analyzing the “true lender” in a bank “partnership” including looking at:
  - The objective terms of the loan to determine whether the bank or the non-bank is the lender
  - Which entity disburses proceeds and takes on the role of risks of the lender
  - Look at the substance of the agreement to determine if the bank is merely fronting for the non-bank and has little or no risk of a lender
  - Is the non-bank lender obligated to and in face regularly sells all loan production to its non-bank “partner”
  - Who funds the loans?

Marketplace Lending -True Lender and Rent a Charter Challenges

- Objective approach: sufficient for bank to be specified as creditor in loan agreement to be considered true lender
  - Deferential to the terms of the arrangement between parties in the bank partnership

- Example: *Beechum v. Navient Solutions, Inc.* No. 2:15-cv-08239-JGB-KK (C.D. Cal. Sept 20, 2016)

Beechum v. Navient Solutions, Inc., No. 2:15-cv-08239-JGB-KK (C.D. Cal. Sept 20, 2016)

- Plaintiffs obtained student loans using applications that identified a national bank as lender
- Non-bank would perform substantially all origination, underwriting, marketing and funding of loans
- Non-bank committed to purchasing loans from bank at specific prices in advance and within 90 days after loan was made

Beechum v. Navient Solutions, Inc., No. 2:15-cv-08239-JGB-KK (C.D. Cal. Sept 20, 2016)

- Governing law required the court to look to the face of the transaction to determine true lender:
  - As pleaded, the plaintiffs alleged that the loans were issued by the bank
  - Claim that the non-bank was effectively the lender was unavailing
    - Substance of transaction: whether a transaction satisfies the elements of usury or falls under a common law exemption to the usury prohibition
    - Form of transaction: whether constitutional or statutory exception applies

Beechum v. Navient Solutions, Inc., No. 2:15-cv-08239-JGB-KK (C.D. Cal. Sept 20, 2016)

- Also offered favorable public policy argument
  - Decreasing demand in secondary market does have an effect on bank's ability to participate in that market

- Compare with *Madden*
  - *Madden*: effect on secondary market does not significantly affect banking powers
  - *Beechum*: holding non-banks liable make non-banks less inclined to buy loans from banks.

Marketplace Lending -True Lender and Rent a Charter Challenges

- "Substantive Approach" Examines the manner in which the bank partnership has been structured, not just the titles of the parties under the agreement

- Three general lines of inquiry
  - Does the bank perform or control the non-ministerial activities normally performed by a lender?
  - Is the bank the real source of funding?
  - Does the bank have an economic interest in the loans and origination-related risk?

- If factors present with the bank, conclusion that bank is true lender is supported

Marketplace Lending -True Lender and Rent a Charter Challenges

- Control of non-ministerial activities
  - Bank controls underwriting guidelines
  - Bank makes the credit decisions, even if it adopts the non-bank's credit algorithms
  - Bank sets loan features, terms, or conditions
  - Bank controls loan fees, rates, and pricing guidelines
  - Bank approves and is identified as lender in marketing materials
  - Bank approves exceptions or material changes to the underwriting guidelines, loan terms and conditions, or fees, rates and pricing

Marketplace Lending -True Lender and Rent a Charter Challenges

- Is the bank the real source of funding?
  - Bank funds loans with own money
  - Bank funds loans on its own balance sheet
  - Bank is not paid for loan before transfer of the loan to the non-bank purchaser

Marketplace Lending -True Lender and Rent a Charter Challenges

- Does the bank have a “true” economic interest in the loans and origination-related risk?
  - Bank holds some loans or interest in the loans in own portfolio
  - Bank holds loans for some time before sale to other entities
  - Bank sells loans at price reasonable related to the loans’ market value at the time of sale
  - Bank is paid for interest accrued during holding period
  - Bank bears risks of the credits and the funding for the loans
  - Bank bears origination-related risk reflected in representations, warranties or covenants in the loan sale agreement with buyers
  - Whether the loans are “true sales”

Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359 (D. Utah 2014)

- Resulted in dismissal of action against non-bank lender

- Bank lender facilitated by non-bank service provider:
  - Consumer provides financial information to permit non-bank to perform credit check
  - If consumer qualifies for loan, consumer signs contract with bank through non-bank platform, often as agent for the bank
  - Bank opens account, funds the financing, then sells receivables to non-bank two days later

Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359 (D. Utah 2014)

- Court acknowledged that the program was structured intentionally to take advantage of banking protections
  - Intent did not affect analysis of arrangement
- Factors found present in arrangement
  - Bank source of funding
  - Bank owned accounts
  - Bank held credit before transfer
  - Bank shares financial interest post sale in receivables

Commonwealth of Pennsylvania v. Think Finance, Inc., *et al.*, No. 14-cv-7139, (E.D. Pa. Jan. 14, 2016)

- Pennsylvania Attorney General Office brought enforcement action against Think Finance for alleged "rent-a-bank" scheme
  - Defendant partnered with a Delaware bank
  - Bank originated the loans
- Lawsuit survived motion to dismiss because Think Finance was alleged to be the *de facto* lender
  - complaint asserted no claims against a national or state chartered federally insured bank
  - Procedural posture (motion to dismiss) responsible for the outcome

Spitzer v. County Bank of Rehoboth Beach, 846 N.Y.S.2d 436 (N.Y. App. Div. 2007)

- New York's Attorney General brought an enforcement action against payday lenders who had entered into “rent-a-bank” scheme
  - Defendants partners with a Delaware bank
  - The bank originated the loans while payday lenders marketed the loans

- The Attorney General alleged that the payday lenders were the true lenders.

- The Court examined the “reality of the arrangement and not the written characterization”

Spitzer v. County Bank of Rehoboth Beach, 846 N.Y.S.2d 436 (N.Y. App. Div. 2007)

- Lenders have 3 “nonministerial” functions:
  - the decision to extend credit;
  - the extension of such credit; and
  - the disbursal of the proceeds of the loan.

- Defendants established that the bank (i) established credit criteria, (ii) determined whether to extend credit and (iii) funded each Loan

- The Court reversed the lower court’s partial summary judgment for the Attorney General due to the existence of questions of fact regarding true lender status.

CashCall, Inc. v. Morrisey, 2013 W. Va. LEXIS 587 (W. Va. 2014):

- The Attorney General filed an injunction against CashCall, Inc. as a result of a rent-a-bank scheme
  - First Bank and Trust of Milbank, a South Dakota based national bank, sold hundreds of West Virginia payday loans to CashCall pursuant to an agreement.

- The lower court found that CashCall, was the true lender and that the agreement was a sham designed to "allow CashCall to hind behind FB&T's South Dakota charter and FB&T's resulting right to export interest rates under federal banking law."

CashCall, Inc. v. Morrisey, 2013 W. Va. LEXIS 587 (W. Va. 2014):

- CashCall had appealed the lower court's use of "predominant economic interest" test to determine true lender status.

- The Supreme Court of West Virginia found multiple examples in which the test had been used in federal "rent –a-bank" cases, all of which found no federal preemption.

- The Supreme Court of West Virginia agreed with the use of the predominant economic interest test and found for the plaintiff.

Consumer Financial Protection Bureau v. CashCall, Inc., No. CV 15-7522-JFW (RAOx) (C.D. Cal. Aug. 31, 2016)

- CashCall attempted to conduct its payday lending business through a South Dakota limited liability company licensed to do business by the Cheyenne River Sioux Tribe, after receiving advice that a tribal lender could make and sell loans to a non-tribal entity under Federal Indian Law without being subject to state usury regulation.
- Arrangement between bank and non-bank
  - Non-bank agreed to purchase bank loans before any money paid by consumer to bank
  - Non-bank guaranteed minimum monthly payment to bank
  - Non-bank funded bank's allowing for loan losses for consumer loans
  - Non-bank paid for bank marketing expenses, bank fees, and agreed to indemnify for litigation costs

Consumer Financial Protection Bureau v. CashCall, Inc., No. CV 15-7522-JFW (RAOx) (C.D. Cal. Aug. 31, 2016)

- Applying predominant economic interest test, court determined that the non-bank was the "true" lender

- Factors
  - Non-bank placed its money at risk
  - Non-bank assumed all economic risks and benefits of the loans immediately upon assignment
  - Non-bank bore the risks of default as well as the regulatory risk
  - Non-bank agreed to indemnify bank for litigation costs

IV. Other Litigation Prompted by *Madden*

Other Litigation Prompted by *Madden*

- *Edwards v. Macy's Inc.*, No. 14 Civ. 8616 (CM), 2016 BL 74248 (S.D.N.Y. Mar. 09, 2016)
  - Court granted motion to dismiss non-bank entity
  - "Fair import" of plaintiff's allegations was that non-bank was acting on behalf of national bank
    - Provided marketing services
    - Provided credit processing
    - Provided customer service related to the accounts
    - Received compensation from national bank for doing so

VI. Future of the Secondary Markets Post-*Madden* and Effects on Secondary and Securitization Participants

VII. Loan Sale Strategies after *Madden*

Strategies to Avoid the Effects of *Madden*

- Avoid loans in the Second Circuit
- Restructure bank partnership agreements
- Compliance with state usury and interest rate laws

Questions?

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APPENDIX 1

BANK POWERS, INTEREST RATES AND LOAN SALES

APPLICABLE STATUTES AND REGULATIONS

November 1, 2016

12 U.S.C. 24(7) General Powers of National Banks

"To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt;…."

Interest Rates, Usury and Preemption of State Law by National Banks

12 U.S.C. 85 - Rate of interest on loans, discounts and purchases

"Any association [national bank] may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that whereby the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Revised Statutes…."

12 U.S.C. 86 - Usurious interest; penalty for taking; limitations

The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of this title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same:

Provided, that such action is commenced within two years from the time the usurious transaction occurred.

Interest Rates Charged by FDIC-Insured State Banks

Federal Deposit Insurance Act Section 27 – State-Chartered Insured Depository Institutions and Insured Branches of Foreign Banks

(a) INTEREST RATES.--In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater. [12 U.S.C. 1831d(a)]

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Federal Deposit Insurance Act Section 27 (Cont'd)

(b) INTEREST OVERCHARGE; FORFEITURE; INTEREST PAYMENT RECOVERY.--If the rate prescribed in subsection (a) exceeds the rate such State bank or such insured branch of a foreign bank would be permitted to charge in the absence of this section, and such State fixed rate is thereby preempted by the rate described in subsection (a), the taking, receiving, reserving, or charging a greater rate of interest than is allowed by subsection (a), when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person who paid it may recover in a civil action commenced in a court of appropriate jurisdiction not later than two years after the date of such payment, an amount equal to twice the amount of the interest paid from such State bank or such insured branch of a foreign bank taking, receiving, reserving, or charging such interest. [12 U.S.C. 1831d(b)]

OCC Regulations

§ 7.4001 - Charging interest by national banks at rates permitted competing institutions; charging interest to corporate borrowers.

(a) Definition. The term “interest” as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, creditor-imposed not sufficient funds (NSF) fees charged when a borrower tenders payment on a debt with a check drawn on insufficient funds, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

OCC Regulations

§ 7.4001 - Charging interest by national banks at rates permitted competing institutions; charging interest to corporate borrowers. (cont'd)

(b) Authority. A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a national bank making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a national bank may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies.

OCC Regulations

§ 7.4001 - Charging interest by national banks at rates permitted competing institutions; charging interest to corporate borrowers. (cont'd)

(c) Effect on state definitions of interest. The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

OCC Regulations

§ 7.4001 - Charging interest by national banks at rates permitted competing institutions; charging interest to corporate borrowers. (cont'd)

(d) Usury. A national bank located in a state the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by a corporate borrower.

§ 7.4008 - Lending by national banks.

(a) Authority of national banks. A national bank may make, sell, purchase, participate in, or otherwise deal in loans and interests in loans that are not secured by liens on, or interests in, real estate, subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any other applicable Federal law.

OCC Regulations

§ 7.4004 – Lending by National Banks

(b) Standards for loans. A national bank shall not make a consumer loan subject to this § 7.4008 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors.

(c) Unfair and deceptive practices. A national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1), and regulations promulgated thereunder in connection with loans made under this § 7.4008.

OCC Regulations

§ 7.4004 – Lending by National Banks (cont'd)

(d) Applicability of state law. A national bank may make non-real estate loans without regard to state law limitations concerning:

(1) Licensing, registration (except for purposes of service of process), filings, or reports by creditors;

(2) The ability of a creditor to require or obtain insurance for collateral or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices;

(3) Loan-to-value ratios;

OCC Regulations

§ 7.4004 – Lending by National Banks (cont'd)

(4) The terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;

(5) Escrow accounts, impound accounts, and similar accounts;

(6) Security property, including leaseholds;

(7) Access to, and use of, credit reports;

OCC Regulations

§ 7.4004 – Lending by National Banks (cont'd)

(8) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;

(9) Disbursements and repayments; and

(10) Rates of interest on loans.

The limitations on charges that comprise rates of interest on loans by national banks are determined under Federal law. See 12 U.S.C. 85; 12 CFR 7.4001. State laws purporting to regulate national bank fees and charges that do not constitute interest are addressed in 12 CFR 7.4002.

OCC Regulations

§ 7.4004 – Lending by National Banks (cont'd)

(e) State laws that are not preempted. State laws on the following subjects are not inconsistent with the non-real estate lending powers of national banks and apply to national banks to the extent consistent with the decision of the Supreme Court in Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al., 517 U.S. 25 (1996):

(1) Contracts;

(2) Torts;

(3) Criminal law

(4) Rights to collect debts;

OCC Regulations

§ 7.4004 – Lending by National Banks (cont'd)

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

(8) Any other law that the OCC determines to be applicable to national banks in accordance with the decision of the Supreme Court in Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al., 517 U.S. 25 (1996) or that is made applicable by Federal law.

Dodd-Frank Act

National Bank Powers

Dodd-Frank Act Section 1044

(a) IN GENERAL.—Chapter one of title LXII of the Revised Statutes of the United States (12 U.S.C. 21 et seq.) is amended by inserting after section 5136B the following new section:

‘‘SEC. 5136C. STATE LAW PREEMPTION STANDARDS FOR NATIONAL BANKS AND SUBSIDIARIES CLARIFIED.

**

‘‘(f) PRESERVATION OF POWERS RELATED TO CHARGING INTEREST.—No provision of this title shall be construed as altering or otherwise affecting the authority conferred by section 5197 of the Revised Statutes of the United States (12 U.S.C. 85) 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, including with respect to the meaning of ‘interest’ under such provision.”

Dodd-Frank Act (Cont'd)

Volcker Rule

Section 619 of the Dodd-Frank Act includes new Bank Holding Company Act Section 13. Subsection 13(g) provides:

"(g) RULES OF CONSTRUCTION.—

***

"(2) SALE OR SECURITIZATION OF LOANS.—Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law."

OCC BC-181– Purchases of Loans in Whole or in Participations

Prudent controls for the purchase of loans and participations should generally include:

- Written lending policies and procedures, including:
  - Obtaining and independently analyzing full credit information both before the participation is purchased and on a timely basis thereafter.
  - Obtaining from the lead lender copies of all executed and proposed loan documents, legal opinions, title insurance policies, UCC searches, and other relevant documents.
  - Monitoring the borrower's performance throughout the life of the loan.

- Independent credit analyses by the purchasing bank;
  - Purchasers should apply the same standards of prudence, credit assessment and approval criteria, and "in-house" limits that would be employed if the purchasing organization were originating the loan.

- Agreement requiring the obligor to transfer credit information to the selling bank and any successor and the selling bank to provide information on the obligor to the purchaser.

- Written documentation of recourse arrangements outlining the rights and obligations of each party.

Fair Debt Collections Practices Act

15 U.S.C. 1692(e)

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt.

15 U.S.C. 1692(f)

A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.

APPENDIX 2

CLEARING HOUSE ASSOCIATION, SIFMA AND AMERICAN BANKERS ASSOCIATION AMICUS BRIEFS

PRACTICAL EFFECTS ON MADDEN

November 1, 2016

JONES DAY®

Clearing House Association, SIFMA and American Bankers Association Amicus Briefs – Practical Effects of Madden

- Valid When Made Doctrine
  - The basis of commerce since 1833
  - Cardinal rule was codified as Section 85 of the National Bank Act
  - Casts doubt on the propriety of any validly originated loan that is sold or transferred.
  - Validity may now may depend on the state in which the borrower resides, the state in which the loan purchaser resides, the law chosen to govern the agreement, and/or the circuit in which the borrower files suit.

Clearing House Association, SIFMA and American Bankers Association Amicus Briefs – Practical Effects of Madden (cont'd.)

- Overturning the valid when made rule reduces the availability of credit and increases the cost of capital for consumers and small businesses.
- Reduction of liquidity and value of loan portfolios could have ramifications for the safety and soundness of the banking system.
- Ability to securitize loans is fundamentally important to the economy as it "lower[s] borrowing costs, release[s] additional capital for expansion or reinvestment purposes, and improve[s] asset/liability and credit risk management.
- Multiple financial institutions have begun limiting their exposure to loans that were valid when made, but could potentially be deemed usurious if sold or assigned..

Clearing House Association, SIFMA and American Bankers Association Amicus Briefs – Practical Effects of Madden (cont.)

- The decision will reduce the availability of credit and hinder banks from acting as financial intermediaries, to the detriment of borrowers, banks and the national economy
  - After Madden, some secondary market participants have refused to purchase loans made to consumers or small businesses in the 2nd Circuit.
  - Moody's - "Madden v. Midland Funding, LLC litigation poses risks to marketplace lenders and related ABS [asset-backed securitizations] by throwing into doubt the presumed legal benefits created by the lenders' use of third-party partner banks to originate loans."