No. 15-610

IN THE

Supreme Court of the United States

MIDLAND FUNDING, LLC; and
MIDLAND CREDIT MANAGEMENT, INC.,

Petitioners,

v.

SALIHA MADDEN,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF *AMICI CURIAE* THE AMERICAN BANKERS ASSOCIATION, THE CALIFORNIA BANKERS ASSOCIATION, AND THE UTAH BANKERS ASSOCIATION IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*

The American Bankers Association (ABA) is the principal trade association of the financial services industry in the United States. ABA members are located in all fifty states, the District of Columbia, and Puerto Rico, and include financial institutions of all sizes that collectively hold a majority of the domestic assets of the U.S. banking industry. The ABA frequently appears as *amicus curiae* in litigation involving issues of widespread importance to the industry.[1]

The California Bankers Association (CBA) is a non-profit organization established in 1891 that represents most of the depository financial institutions insured by the Federal Deposit Insurance Corporation (FDIC) doing business in California. CBA members range in size from the smallest community banks to the largest banks in the country. The CBA advocates on behalf of its members before state and federal legislatures, executive agencies, and courts on matters significant to the banking community.

The Utah Bankers Association (UBA) is the professional and trade association for Utah's commercial banks, savings banks, and industrial loan corporations. Established in 1908, the UBA serves, represents, and advocates the interests of its members.

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[1] No counsel for a party authored this brief in whole or in part. No one other than *amici curiae*, their members or *amici*'s counsel made a monetary contribution intended to fund the preparation or submission of this brief. Counsel of record for all parties received notice at least ten days prior to the due date of *amici*'s intention to file this brief. E-mail messages from counsel for the parties consenting to the filing of this brief have been filed with the Clerk of the Court.

The UBA strives to promote understanding of the banking industry and maintain the public confidence in the strength and security of Utah's financial services industry.

Amici have a direct and substantial interest in the issues presented in the petition. *Amici*'s members, like the rest of the lending community in the United States, depend on stable markets for loans, including a secondary market that allows banks to sell loans and thereby extend additional credit. The decision of the Second Circuit in this case threatens to disrupt these markets and to impair the ability of *amici*'s members to exercise their statutory authority to make and sell loans, in conflict with longstanding precedent and fundamental principles of federal preemption.

INTRODUCTION AND SUMMARY OF ARGUMENT

The business of bankers is lending. Bank loans facilitate the commercial investment, consumer expenditures, and economic growth that support the American standard of living. In today's banking environment, efficient lending requires not only a functioning primary market in which banks make loans to borrowers, but also an efficient secondary market in which banks sell loans to other parties. Without an efficient secondary market, banks would have less free capital with which to meet the credit needs of their communities. They would also face constraints on their ability to diversify against risks associated with concentrated lending in particular geographic, product, or credit-quality market segments.

The decision below upsets the banking industry's longstanding and settled understanding that the National Bank Act (NBA) preempts the application of state usury laws to loans originated by a national bank, whether those loans are held by the national bank itself or are sold to another entity. The Second Circuit's contrary holding conflicts with this Court's precedents, other circuit court decisions, and the objectives of the national bank charter. Unless corrected by this Court, the decision below will disrupt the secondary market for loans, upon which the primary market for lending depends; as a result it will chill the primary market for making loans and thereby increase the costs borrowers face.

The NBA preempts any application of state law that would "significantly impair, . . . burden[,] . . . curtail[,] or hinder a national bank's efficient exercise of any . . . power, incidental or enumerated under the NBA." *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12–13 (2007) (citing *Barnett Bank of Marion City., N.A. v. Nelson*, 517 U.S. 25, 33–34 (1996); *Franklin Nat. Bank of Franklin Square v. New York*, 347 U.S. 373, 375–79 (1954)). A provision of the NBA—12 U.S.C. § 85—specifies that the usury limits of a national bank's home state govern loans of that national bank regardless of the state in which the borrower resides, where the collateral is located, or whose law might apply for some other reason. The "cardinal rule of usury" is that when a national bank sells a loan that is non-usurious by virtue of 12 U.S.C. § 85, the loan cannot subsequently become usurious in the hands of a purchaser, whoever that may be, Pet. App. 28a (citing *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833))—and whatever state's law might otherwise apply—because a national bank's core loan origination and sale operations would be "significantly impaired" if state

usury laws limited the contractual interest rate after a sale of the loan.

The swift backlash from the banking community reflects the wide-ranging adverse effects of the decision below. *See* Peter Rudegeair, *A New Tariff on 'Interest-Rate Exports?'*, Wall Street Journal (June 30, 2015); *see also* Pet. 21 (collecting media reports and noting that ten industry associations filed *amicus* briefs in support of rehearing below). These adverse effects extend to nearly every lending sector and will restrict the availability of loans to countless borrowers, particularly those with less access to traditional lending sources.

This case presents an excellent and timely vehicle to consider the question presented. The legal issue is squarely presented, and the parties have stipulated to the relevant facts. Pet. App. 51a–55a. The question is timely because national banks need immediate guidance on the preemptive effect of the NBA, which is intended to create a uniform and stable national market for their operations and assets—a uniformity that is disrupted by the existing circuit split. This Court should grant certiorari to resolve one of the most consequential and pressing questions facing the banking system today.

THE WRIT SHOULD BE GRANTED

I. The circuit split created by the decision below disrupts the national uniformity critical to the efficient operation of the banking system.

The question presented implicates a legal issue at the heart of the National Bank Act: whether the Act, which preempts state usury laws regulating the interest a national bank may charge on a loan, continues to have preemptive effect after the national bank sells or otherwise assigns the loan to a party that is not itself a national bank. Two circuits have answered that question in the affirmative. The Eighth Circuit held that "[c]ourts must look at 'the originating entity (the bank), and not the ongoing assignee . . ., in determining whether the NBA applies.'" *Phipps v. FDIC*, 417 F.3d 1006, 1013 (8th Cir. 2005) (quoting *Krispin v. May Department Stores Co.*, 218 F.3d 919, 924 (8th Cir. 2000)). The Fifth Circuit similarly held that the applicable law is determined by looking at the loan's originator, the national bank, in determining the continuing preemptive force of the NBA. *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148–149 (5th Cir. 1981).

In contrast, the Second Circuit in the decision below disregarded the "cardinal rule of usury" that the non-usurious character of a loan does not change by virtue of a subsequent transaction involving the loan. Pet. App. 28a (citing *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833)). The Second Circuit split with the Eighth and Fifth Circuits by holding that the NBA's preemption did not extend to national bank loans once they are sold or assigned to an entity that is independent of a national bank. The Second Circuit

concluded that the application of New York usury laws—which eliminated all value in the loan originated by the national bank as soon as it was sold on the secondary market—"would not 'significantly interfere' with the exercise of a national bank power." Pet. App. 11a. The holding below is contrary to the position of federal banking regulators. *See* U.S. Dep't of the Treasury, Office of Thrift Supervision, Opinion Letter No. P-2003-5 at 7 n.18, 2003 WL 24040104 (July 22, 2003) ("the general principle [is] that loan terms should not change simply because an originator entitled to federal preemption may sell or assign a loan to an investor that is not entitled to federal preemption").

1. The circuit split on this question is exceptionally important to the national banking community. Lenders and servicers depend upon a stable, predictable, and consistent national legal framework to operate efficiently. Congress intended for banks that organize under a federal charter to operate free from many of the restrictions of state law and from the confusion and burden that compliance with a patchwork of multiple (and ever-changing) state laws would entail. While a bank's choice to organize under a state or federal charter involves a variety of factors, a central consideration is the extent to which the bank wishes to be subject to either state banking laws or federal banking laws.

The Office of the Comptroller of the Currency (OCC) articulated the dangers that arise when the consistent federal framework enjoyed by national banks is compromised: "When national banks are unable to operate under uniform, consistent and predictable standards, their business suffers and so does the safety and soundness of the national banking

system. . . . The application of multiple and often unpredictable state laws interferes with their ability to plan and manage their business, as well as their ability to serve the people, the communities and the economy of the United States." News Release, Office of the Comptroller of the Currency (Jan. 7, 2004).

This Court, too, has long emphasized the need for uniformity in the interpretation and application of national banking laws. As the Court stated in *Easton v. Iowa*, 188 U.S. 220, 229 (1903), the NBA reflects Congress's vision "of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the states." *See also Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314–315 (1978) ("Close examination of the National Bank Act of 1864, its legislative history, and its historical context makes clear that . . . Congress intended to facilitate . . . a 'national banking system.'" (citation omitted)).

2. The decision below acknowledged the well-established rule that the NBA preempts state laws that "significantly interfere with a national bank's ability to exercise its power[s]," and that "NBA preemption may extend to entities beyond a national bank itself." Pet. App. 8a. But the Second Circuit failed to recognize that its holding allows—indeed causes—state usury law to significantly interfere with core national bank powers.

The "powers" of national banks indisputably include the power to originate and sell loans. 12 U.S.C. § 371 (granting national banks the power to "make, arrange, purchase or sell loans"); *id.* § 24 (Seventh) (granting national banks "all such incidental powers as shall

be necessary to carry on the business of banking"). OCC regulations confirm that national banks may "make, sell, purchase, participate in, or otherwise deal in loans" without regard to state-law restrictions. 12 C.F.R. § 7.4008(a); *see also id*. § 34.3(a) (similar). These OCC regulations "have no less pre-emptive effect than [the] statute[]" itself. *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305, 314 (2d Cir. 2005).

However, in the decision below, the panel wrongly held that in the context of interest-limiting (usury) statutes, such preemption extends only to entities over which national banks "exercise control" and does not extend to "third-party debt buyers," because such entities do not "act on behalf of" national banks and do not "exercise[] the powers of a national bank." Pet. App. 9a.

This limited conception of the scope of NBA preemption is misguided. This Court has found that NBA preemption exists wherever the effect of any state law—however and to whomever applied—would "impair significantly[] the exercise of a power that Congress explicitly granted" to national banks. *Barnett Bank*, 517 U.S. at 33. Simply put, if a state law—whether applied to a national bank or another entity—significantly "interfere[s] with," "encroac[hes]" upon, or "hamper[s]" the exercise of a national bank's power to make and sell loans to an independent third party, that state law is preempted. The decision below will seriously disrupt the secondary market for national bank loans, thereby severely interfering with national banks' powers to make and sell loans, as explained in Part II below.

This Court should grant certiorari to clarify this important question, which is central to the national

banking system, and should restore the national uniformity necessary to that system's efficient operation.

II. The practical effects on the secondary and primary loan markets are wide-ranging and potentially catastrophic.

It is difficult to overstate the extent to which national banks' powers would be impaired if the laws of fifty states—rather than the NBA—could dictate the maximum interest rates on the loans that national banks sell into the secondary market. As the Chief Counsel of the OCC explained to Congress in 2004, allowing the terms of a loan made by a national bank to change when the loan is sold would "substantially affect the marketability of such loans," impairing the bank's power to sell and, by extension, to make new loans. Congressional Review of OCC Preemption, Hearing Before the H. Subcomm. on Oversight & Investigations of the H. Comm. on Fin. Serv., 108th Cong. 205 (2004) (statement of Julie L. Williams, First Senior Deputy Comptroller of OCC & Chief Counsel). *Cf. Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 146 (1982) (allowing states to regulate residential loans assigned by federally chartered banks would "restrict and impair the ability of Federal associations to sell their home loans in the secondary mortgage market[] by making such loans unsalable or causing them to be sold at reduced prices, thereby reducing the flow of new funds for residential loans, which otherwise would be available").

National bank loans exceed $5 trillion and constitute the majority of real estate, commercial, credit card, and automobile loans in the United States—all of which are affected by the decision below. *See* FDIC, Bank Data & Statistics, Sept. 30, 2015, https://www5.

fdic.gov/sdi/main.asp (Retrieve Reports, Standard Report #4). National banks will sell a material portion of those loan assets, exceeding $1 trillion, into the secondary market. In 2014 alone, secondary loan trading volume in the United States reached an all-time high of $628 billion. Kerry Kantin, *US Leveraged Loan Trading Volume Hits Record $628B in 2014*, Forbes (Feb. 5, 2015).

The implications of disrupting the efficiency of this market extend far beyond banks. For example, ripple effects will be felt in the national bank loan securitization industry, which the U.S. government facilitates through government entities such as the Federal Housing Administration, and via its creation of government-sponsored enterprises such as Fannie Mae and Freddie Mac. Insurance companies, asset managers, private equity funds, and various other market participants frequently rely on national banks to supply them with a robust investment pipeline of loans. These non-bank entities—some of which have been recognized as systemically important financial institutions whose stability is critical to the national economy—purchase bank loans to properly balance their portfolios and manage risk. Effective risk management requires a liquid market for loan assets with a variety of geographic, collateral, term, and credit-quality attributes. Although the specific transaction underlying the Second Circuit's decision involved charged-off assets (*i.e.*, a defaulted loan that had been written off), Pet. App. 3a, the court's reasoning applies equally to all loans a national bank might sell. Thus, the decision affects not just the narrow market segment comprising non-performing loans, but instead the entire secondary market for loans originated by national banks.

Under the decision below, the market for those assets is less liquid and less efficient, because each market participant faces risk that the loans they acquire from national banks could be valueless, or, worse, that the assignee could be subject to criminal penalties. It is no answer to suggest that with greater diligence buyers could manage the risk that a purchased loan would become subject to an onerous usury limit. Increased loan-by-loan diligence would be burdensome, driving down market efficiency and increasing the costs ultimately borne by lenders and, by necessary extension, borrowers. And increased diligence could not eliminate the risks the decision below creates in any event. No matter how much diligence a loan purchaser undertakes, it cannot always foresee where a borrower might choose to litigate a usury claim, and therefore which side of the circuit split might govern claims related to the purchased loan.

Because of these uncertainties and risks, national bank loan-sale transactions are becoming far more complex and cumbersome. ABA members report that some buyers are insisting that future transactions include additional, special-purpose entities to hold loans deemed at greater risk of being affected by the decision below, while others insist that the selling bank retain an interest in certain kinds of loans, thereby consuming some of the regulatory capital that would otherwise support additional lending following the loan sale. All of these effects increase the transaction costs of secondary-market loan sales, thereby driving a price wedge between potential buyers and sellers, which in turn reduces market efficiency.

These disruptions to the secondary market for purchasing loans also will negatively affect the primary

market in which bank loans are made, increasing costs borne ultimately by borrowers. The availability of a liquid and efficient secondary market into which national banks may sell their loans is a significant driver of both a national bank's ability and desire to make loans in the first instance. A bank's ability to make additional loans depends upon holding sufficient regulatory capital in comparison to the level of assets the bank owns; holding existing loans in a bank's portfolio rather than selling them therefore constrains the bank's ability to make more loans. *See generally United States v. Winstar Corp.*, 518 U.S. 839, 850–851 (1996); 12 C.F.R. pt. 3. By selling loans, national banks can convert loan assets into cash with which they can extend additional credit.

Even beyond its effect on liquidity, the decision below discourages national banks from lending to additional borrowers—especially marginal borrowers with the least access to credit—because national banks now face the risk that such loans cannot be sold on the secondary market. Naturally, if a national bank believes a loan asset may be unsalable on the secondary market, the bank is less likely to create the asset—*i.e.*, make the loan—in the first instance.

In a broader sense, the decision below inhibits national banks from continuing to specialize in loan origination. Banks are credit intermediaries that indirectly connect providers of capital with borrowers of capital. ANTHONY SAUNDERS & MARCIA M. CORNETT, FINANCIAL INSTITUTIONS MANAGEMENT: A RISK MANAGEMENT APPROACH 3–5 (6th ed. 2008). Banks specialize in identifying people and businesses with credit needs, analyzing their credit-worthiness, and negotiating and executing loan documents. Banks may also service the loans but, increasingly, choose

not to do so and, instead, outsource that function to specialized parties, such as loan servicers, investors bearing the economic risks of the loans (or of securitized loan derivatives), and debt collectors retrieving delinquent loans. PETER LINNEMAN, REAL ESTATE FINANCE & INVESTMENTS: RISKS AND OPPORTUNITIES, 140–141 (2d ed. 2008). The separation of origination, servicing, and ownership of loans into independent functions allows non-banks to invest in bank loans where appropriate and desirable on a purely financial basis, because investors can rely on third parties to handle the more practical aspects of loan administration.

Such specialization is good for banks and good for the overall economy. By selling loans, banks with a comparative advantage in identifying potential borrowers, analyzing creditworthiness, and evaluating collateral can free up their capital to make more loans. By purchasing loans, other entities with specific risk-management needs gain access to a liquid supply of credit instruments with a variety of rate, term, collateral, and credit attributes—all without the burden of having to build out their own credit-marketing and underwriting structure, which might well require acquiring a bank charter. In each case, the ability of banks to focus on their special role as credit originators and intermediaries depends on their ability to sell their loans to other specialized parties.

Introducing impediments to the secondary market is particularly pernicious for banks in distress. Banks are motivated to sell certain loans in times of distress to minimize losses, maximize risk-adjusted returns, and maintain adequate liquidity, as bank regulators expect. *See* OCC Comptroller's Handbook, Loan Portfolio Management 7 (1998) ("A bank's overall

liquidity strategy should include the identification of those loans or loan portfolio segments that may be easily converted to cash."). The decision below restricts such banks' ability to sell loans quickly, at the fair market value their terms and conditions would support absent the uncertainty injected by the decision below, precisely at a time when troubled banks need liquidity the most.

The decision below also will significantly disrupt existing credit contracts. More than forty states prescribe economic remedies for usurious agreements, such as forfeiture of all interest paid, recovery of double the usurious amount, payment of a fine, or voiding the underlying agreement. *See* Gale, *50 State Statutory Surveys: Business Organizations: Consumer Protection: Interest Rates* (2007) (search "0015 SURVEYS 8" in Westlaw). In several states, usury violations amount to criminal misconduct, punishable by imprisonment. *Id.* (noting 18 states that criminalize usury). New York law both voids the loan and penalizes the lender. N.Y. Gen. Oblig. Law §§ 5-501, 511; N.Y. Penal Law § 190.40.

State usury laws also may subject the selling national bank to additional, private legal risks. National banks, like other loan sellers, must generally provide representations and warranties of enforceability as to the loans they sell. Because the Second Circuit's decision would subject different buyers to different rules—rules that depend on the borrower's choice of litigation forum and that would therefore be inherently unknowable at the time of a loan sale—the complexity and cost of providing such representations and warranties will increase dramatically. And even if those costs and burdens are surmounted, selling banks will face "put-back" risk under common

loan-sale-agreement provisions requiring the seller to repurchase assets from a buyer where there has been an unexpected change in asset value. Indeed, the decision below is expected to spur significant and costly litigation in the coming years over buyer protections in the representations, warranties, and other terms of existing credit agreements.

The petition presents an ideal and timely vehicle to address these adverse effects before they take root in the industry. Granting plenary review now would avoid opportunistic exploitation of the division among the circuits, where plaintiffs could opt to bring suit in the Second Circuit, which includes New York, the U.S. financial capital. The stakes are too high to postpone consideration of the merits.

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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