

# Senate Banking Committee Hearing: Oversight of Financial Regulators

December 5, 2019

## Valid-When-Made Doctrine and the Madden Decision

- Chairman Mike Crapo (R-ID) first brought up the “Valid-When-Made” doctrine and the recent *Madden* decision by asking FDIC Chairman Jelena McWilliams about the uncertainty for secondary markets that she said would result from it. Chair McWilliams describing the FDIC’s expectation that the ruling will mean banks will be unable to sell loans in the secondary market due to risks that the contract terms will not carry over, which could affect bank liquidity, especially in times of crisis.
- The centerpiece of this discussion, however, came in an exchange between Sen. Mark Warner (D-VA) and Chair McWilliams. Sen. Warner first noted that, while the OCC’s and FDIC’s rulemaking was supposed to provide clarity in wake of the Madden decision, he felt that it was probably premature to move forward, since FDIC claims it isn’t aware of any effects of the decision on secondary markets as yet. Sen. Warner further noted his concern (shared by FDIC Commissioner Marty Gruenberg) doing so may have “put (a) foot on the scale in a blunt way” that will give a green light to some of the “rent-a-bank schemes” noted by critics and participants in the HCFS 12/4 hearing. He then reminded Chair McWilliams of her statement in the House hearing that she only wanted to address and clarify the longstanding valid-when-made principle and asked whether she would consider a loan usurious if its sole purpose at time of origination was to evade interest rates under state laws. Chair McWilliams stated that the position the FDIC takes is to determine the home state for the bank, which has its own test, when making that determination, that many members and critics have been conflating the “valid-when-made” doctrine with a separate “true lender” doctrine the proposal literally took what authority the FDIC and OCC had pre-Madden, and opened it up for comment.
- Sen. Warner then pressed Chair McWilliams on the issue, particularly as it related to non-bank lenders, and cited reports from a recent conference call where a COO of such an institution said that they expect to continue to serve CA consumers through “bank sponsors” that are “not subject to same proposed state level rate limitations.” He asked why the FDIC doesn’t simply provide guidance in their rule as to what the test is or provide a standard for what a valid loan that doesn’t violate state usury laws would be, stating that without that, it’s giving a “greenlight” to these schemes. Chair McWilliams pushed back, stating outright that people who say it’s a “greenlight” are mistaken, before telling Sen. Warner that states have the right under Section 27a of the Federal Deposit Insurance Act to opt out of the interest

rate portability regime and reiterated her statement from the House hearing that the FDIC specifically said they look unfavorably on rent-a-bank charters, with the purpose of the doctrine not being to empower evasion of state laws and the commitment of FDIC to not allow it.

## Leveraged Lending

- Sen. Sherrod Brown (D-OH) asked Vice Chair Randal Quarles a series of questions related to leveraged debt, asking specifically about the nursing home example he mentioned in his opening statement, which was undertaken by the Carlyle Group when Vice Chair Quarles was employed there. Vice Chair Quarles first stated that he wasn't involved with that transaction, and so couldn't speak to it specifically, but that it was important to have a system where private equity brings benefits to companies, and that the financial system should create incentives to improve companies private equity invests in. When asked what Vice Chair Quarles would need to see to crack down on leveraged lending of this sort, he said that the Fed has already taken supervisory action against some companies in relation to the issue and that he hadn't said it wasn't a problem, and that the Fed has to assess balance between whether there is a financial security risk posed by this activity v. potentially contributing to a future business downturn of altering current underwriting practices. Addressing the latter concern, Vice Chair Quarles further noted that it was a focus of the last two shared national credit examinations to assess leveraged lending and evolution of underwriting practices, which are concerns to the Fed.
- In response to questioning from Sen. Thom Tillis (R-NC), Chair McWilliams stated that transparency in regulation was a goal of the FDIC as they update regulations that haven't been touched to account for changes in the banking sector, including going public with updates to previously "one-off" regulations and to be more uniform in applying laws and rulemakings going forward.

## Collateralized Debt Obligations

- Sen. Warner asked about the Financial Stability Board's analysis of Collateralized Debt Obligations, which Mr. Quarles stated was being circulated for final sign off with an expected publication in the new year.

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