FDIC Federal Deposit Insurance Corporation

FACT SHEET

FDIC Issues Rule to Codify Permissible Interest on Transferred Loans

- In 1980, Congress enacted the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which created Section 27 of the Federal Deposit Insurance Act authorizing State banks to charge interest at a rate that is permissible in the state where the bank is located.

- The FDIC has interpreted and applied this law to State banks through an opinion of the General Counsel issued in 1998, but the agency did not enact corresponding regulations.

- Recent court decisions have raised significant uncertainty regarding this longstanding application of Section 27 to State banks operating across interstate lines. Specifically, in 2015, in *Madden v. Midland Funding, LLC*, the United States Court of Appeals for the Second Circuit called into question the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a non-bank which has subsequently decreased credit availability for borrowers with lower credit scores.[1]

- Although the decision concerned a loan made by a national bank, the statutory provision governing FDIC-supervised state banks' authority with respect to interest rates is substantively identical.

- The FDIC is issuing a final rule to clarify that the valid interest rate for a loan is determined when the loan is made, and will not be affected by a subsequent sale, assignment, or other transfer of the loan. The rule:

    - **Codifies longstanding FDIC guidance** through a formal rulemaking process to provide the public with an opportunity to comment.

    - **Addresses marketplace uncertainty** regarding the enforceability of the interest rate terms of a loan agreement following a bank's assignment of a loan to a non-bank.

    - **Promotes safety and soundness** by giving certainty to banks that sell loans into the secondary market as a way to meet deposit withdrawal demands, pay debt obligation, and make new loans.

    - **Supports the stability of the nation's financial system** by ensuring that the FDIC can satisfy its statutory duty as conservator or receiver to maximize the return on sale or disposition of assets and minimize the loss to the Deposit Insurance Fund.

- The final rule does not address a separate question regarding the issue of "true lender" in lending arrangements between banks and third parties, and preserves the states' ability to opt out of coverage under Section 27 in accordance with Section 525 of DIDCMA.

[1] *See* Colleen Honigsberg, Robert Jackson and Richard Squire, "How Does Legal Enforceability Affect Consumer lending? Evidence from a Natural Experiment," *Journal of Law and Economics*, vol. 60 (November 2017); and Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy" (July 5, 2018). Available at http://ssrn.com/abstract=3209808 or http://dx.doi.org/10.2139/ssrn.3208908.

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