Pepper Hamilton LLP
Attorneys at Law

1313 N. Market Street
Suite 5100
Wilmington, DE 19899-1709
302.777.6500
Fax 302.421.8390

Richard P. Eckman
direct dial: 302.777.6560
direct fax: 302.397.2707

February 4, 2020

VIA ELECTRONIC SUBMISSION

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Company
550 17th Street NW
Washington. DC 20429

Dear Mr. Feldman:

Our client appreciates the opportunity to comment on Notice of Proposed Rulemaking **RIN 3064-AF21 – Federal Interest Rate Authority** and welcomes the FDIC's willingness to address the legal uncertainty *Madden* created regarding the authorities of State banks under section 27. That uncertainty continues to pose serious legal obstacles not just for banks, but for the non-bank technology service providers that banks increasingly depend on in offering financial services to consumers. Pepper Hamilton has been at the forefront of financial innovation by representing numerous bank and nonbank clients who offer unique technology-based financial products and services. Our ever deepening experience in the fintech segment of financial services has given us a broad perspective on what federal regulators such as the FDIC must do in order to drive financial innovation in a manner that fosters financial inclusion. As the FDIC has recognized in its written guidance and public speeches, responsible relationships between banks and fintechs are a key component in making the promise of inclusion come into reality. Our client offers a number of services relating to marketplace lending programs as a third-party service provider to State banks. As a result, it has a strong interest in the outcome of this rulemaking.

The proposed rulemaking comes at a time when millions of low to moderate income consumers are facing increased difficulty in obtaining credit. An article entitled, "Credit Scores to Drop for Millions," which appeared in the Wall Street Journal on January 22, 2020, noted that changes being made to the methodology Fair Isaac Corp. uses to calculate FICO scores "will likely make it harder for many Americans to get loans." Innovative underwriting services made

available to State banks by fintech providers, along with the availability of marketplace lending programs, enable banks to serve the credit needs of consumers who would otherwise look to unregulated lenders to serve their needs.[1] Absent that added capability, State banks would be at increased risk of becoming displaced as a primary source of financial services for a large portion of the U.S. population.[2]

A Rule Interpreting Section 27 Cannot Exclude Addressing the Real Party in Interest

In its Federal Register comments, the FDIC states that the proposed rule will not address whether the bank is "the real party in interest with respect to a loan or has an economic interest in the loan under state law; e.g., which entity is the true lender." Those exclusions are unnecessary and belie the critical importance with which the Second Circuit viewed the issue of whether or not a bank was the real party in interest in *Madden*. In addition, we note that in its parallel recent rulemaking the OCC described what was out-of-scope for purposes of the true lender issue more narrowly; i.e., "This rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party."[3] As is further explained below, this difference in scope could create material differences between what the FDIC describes in its Federal Register comments as parallel rulemakings that are intended to establish *in pari materia* interpretations of section 27 of the Federal Deposit Insurance Act and section 85 of the National Bank Act, respectively.

In *Madden*, the Second Circuit framed the federal preemption issue before the court as whether the usury laws of the State of New York significantly interfered with the ability of a national bank to exercise its rights under section 85 of the National Bank Act. In finding that the application of New York law "would not significantly interfere with any national bank's ability to exercise its powers under the NBA," the court devoted much of its opinion to distinguishing the decision of the Eighth Circuit in *Krispin v. May Department Stores*.[4] Specifically, the court found *Krispin* inapplicable because the bank had retained ownership of the subject loan accounts and thus, was the "real party in interest." According to *Madden*, this finding in *Krispin* was essential to the Eighth Circuit's ultimate conclusion that the "application of state law to the

---

[1] The FDIC notes in the Expected Effects portion of its Federal Register comments that "in the absence of the proposed rule . . [underbanked] consumers might be unable to obtain credit from State banks and might instead borrow at high rates from less-regulated lenders."

[2] FDIC Chairman Jelena McWilliams has highlighted this risk in a number speeches; see, e.g., https://www.fdic.gov/news/news/speeches/spnov1318.pdf

[3] 84 Fed. Reg. 84229, 8432

[4] 218 F.3d 919 (8th Cir. 2000).

accounts [contested in that case] would have conflicted with the bank's power's authorized by the NBA."[5]

The critical importance of knowing whether a bank is the real party in interest is illustrated by the decision of the state district court of Colorado in *Meade v. Funding*, which was issued in August 2018.[6] The *Meade* court found it unnecessary to even consider the valid when made doctrine because "the Administrator's factual allegations assert[ed] that the Marlette and Avant loans made to Colorado consumers were *invalid when made*. . ."[7] Rather, the court opined that "the real question" that needed to be addressed was whether "those loans were valid in the first place. . ."[8]

In OCC Interpretative Letter 822, which the FDIC substantially mirrored in General Counsel Opinion 11, the OCC noted that "clear rules" governing the ability of a national bank to charge interest are consistent with the need many courts have recognized for "a company with far-flung operations to adopt a uniform law to govern its transactions. . ."[9] A rule that stopped short of addressing whether the bank is the lender, and instead left that question to be decided by the respective court systems of each state – effectively providing, *if* a State bank is the lender, *then* section 27 governs the lawful rate of interest – would be at odds with a uniform standard.

Fact-Intensive 'True Lender' Tests Are Unnecessary

There is no need for the FDIC to undertake fact-intensive 'true lender' inquiries, similar to what some state courts perform, in order to provide clear and unambiguous direction in the proposed new rule. First, and foremost, the FDIC could clarify what it means for purposes of section 27 for a State bank to "take, receive, reserve, and charge on any loan or discount *made*, . . ." without performing a court-like true lender analysis. The FDIC did just that in General Counsel Opinion 11 when it adopted a "non-ministerial activities" test for determining when and

[5] *Madden v. Midland Funding, LLC*, 786 F.3d 246, 252 (2d Cir. 2015), cert. denied, *Midland Funding, LLC v. Madden*, 2016 U.S. 2039 (U.S., 2016).

[6] 2018 Colo. Dist. LEXIS 3856 *.

[7] *Id*. at *57.

[8] *Id*. at *58.

[9] OCC Interpretive Letter No. 822 (Feb. 17, 1998), footnote 32.

where a loan is "made" for purposes of interstate branch banking.[10] Unlike the true lender tests that courts employ, the relatively simple three-part test established in General Counsel Opinion 11 focuses on certain core lending activities performed by the State bank itself (i.e., "non-ministerial" activities) , as opposed to ancillary activities performed by non-bank third party service providers, such as loan program marketing and account servicing (i.e., "ministerial" activities).[11]

We urge the FDIC to establish a clear-cut rule for identifying when a loan is made by a State bank through expanding the coverage of the test previously adopted in General Counsel Opinion 11. To this end, consistent with the FDIC's statement of policy in its Federal Register preamble disfavoring lending arrangements where a non-bank is seeking to use a State bank's charter solely as a means of evading state usury laws, the fact that a bank *would* be the lender if a given loan or category of loans is made does not mean that the subject bank *should* lend as matter of policy, including in view of the policies promulgated and maintained by the applicable state banking agency in the state, or multiple states, where the bank is located.

Second, the FDIC should recognize, consistent with *Krispin* and *Madden*, that section 27 applies in all cases where a State bank is both named as the lender in the loan documents and continues to own the loan accounts. This is what exists under any loan participation-based marketplace lending program, which has emerged as the predominate structure for such programs. If the bank owns the loan accounts, then the laws, supervisory expectations, safety and soundness standards, and expectations for the fair and equitable treatment of customers that apply to the bank will necessarily apply throughout the loans' entire product and service lifecycle. The FDIC strongly emphasized this point in its draft Proposed Guidance for Managing Third Party Lending, which we urge the FDIC to finalize. The specific standards that apply to marketplace lending programs include those set forth in the FDIC's Guidance for Managing Third-Party Risk, FIL 44-2008, and its Supervisory Guidance on Model Risk Management, FIL 22-2017.[12] We further note that the OCC's rulemaking, which only treats marketplace lending

---

[10] Notwithstanding the FDIC's Federal Register discussion of General Counsel Opinion 11, proposed Part 331.2 (Definitions) includes no definition of the term "made" in any context, including interstate branch banking.

[11] In *Discover Bank v. Vaden*, 396 F.3d 366, 367 (4th Cir.2005), at the request of the Fourth Circuit Court of Appeals, the FDIC concluded that Discover Bank, and not its corporate affiliate Discover Financial Services, Inc., as alleged by the plaintiff, was the true lender based on an analysis that centered on the bank's activities and responsibilities. In contrast, the true lender analyses applied by state courts when considering a marketplace lending program focus almost entirely on the non-bank party.

[12] If those standards are not being properly adhered to, the FDIC has the ability to enforce them through formal enforcement action. See, e.g., the FDIC's March 2018 consent order action against Cross River Bank: https://www.fdic.gov/news/news/press/2018/pr18021a.pdf

programs in which loans are assigned by the bank as out of scope, and does not treat the sale of an economic interests in loans as a material factor for purposes of section 85, could accommodate this outcome.

Predominate Economic Interest Should Be Considered Irrelevant

A stated goal of the proposed rulemaking is to "reaffirm the ability of State banks to sell and securitize loans they originate." Yet, a transfer of the predominate economic interest in subject loans is the intended outcome of every loan securitization. Therefore, it would be seemingly impossible for the proposed rule to both provide the above-stated reaffirmation and ignore the bank's "economic interest in the loan under state law," as is proposed. Moreover, it is also confusing for the FDIC to assert in proposed Part 33.4(e) that "Whether interest on a loan is permissible under section 27. is determined as of the date the loan was made," yet leave open the possibility that the sale by a State bank of its economic interests in loans made, including its contractual commitment to sell future loan receivables, could wind up deciding whether or not the bank was the true lender in state court.

In sum, our client strongly supports the intended purposes of the proposed rule, but believes those purposes are at risk of being frustrated unless the FDIC clarifies that whether a State bank holds the predominate economic interests in the loans has no relevance for purposes of section 27.

Conclusion

The FDIC continues to be a welcome and highly influential champion of financial innovation. The proposed rule offers the FDIC a unique opportunity to not only undo the unfortunate effects of Madden, but to further innovation by eliminating legal uncertainties that currently dissuade most State banks from even considering engaging in marketplace lending programs aimed at lower-income borrowers. To foster continued innovation, the proposed rule needs to address whether a State bank is the real party in interest by defining when a loan is "made." In this regard, the fact that the bank is named as the lender in loan documents and holds the loan accounts should be considered dispositive of whether section 27 applies, consistent with *Krispin*. At a minimum, the final Rule needs to make clear that the sale of a loan includes the transfer of any economic interest in the loan to a third party to avoid uncertainty in the marketplace, especially as it relates to securitizations. Finally, whether a State bank holds the predominate interest should be considered as irrelevant for purposes of section 27

Thank you again for inviting public comment on the proposed rulemaking. Please be assured that our client is grateful to the FDIC for its willingness to address the vitally important legal issues in question.

Please do not hesitate to call email me if you have any questions regarding the above.

Sincerely,

Richard P. Eckman
Of Counsel

Mark T. Dabertin
Special Counsel