American Bankers Association
Building Success. Together.

Jonathan Thessin
Senior Counsel
Consumer & Regulatory Compliance
Regulatory Compliance and Policy
Phone: 202-663-5016
E-mail: Jthessin@aba.com

February 4, 2020

Via Regulations.gov

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

Re: Notice of Proposed Rulemaking, Federal Interest Rate Authority, 84 Fed. Reg. 66,845 (Dec. 6, 2019) [RIN 3064–AF21]

Dear Mr. Feldman:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking (Proposed Rule).[2] In the Proposed Rule, the FDIC affirms the "valid-when-made" doctrine for State-chartered banks and insured branches of foreign banks (collectively, state banks) by clarifying that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made and the permissibility of that interest is not affected by subsequent events.

I. Summary of Comment

The "valid-when-made" doctrine reflects the longstanding and settled understanding that if a loan is valid when it is made, with respect to the interest rate and other terms of the loan, then the loan remains valid and enforceable when assigned to another party. The doctrine provides critical legal certainty necessary for the effective and efficient functioning of credit markets. Efficient lending by banks requires not only a functioning primary market in which banks make loans to borrowers, but also a robust secondary market in which banks sell their loans to other parties. Without an efficient secondary market, banks' ability to sell loans to diversify their holdings will be impaired, injecting risk into the safety and soundness of our nation's banking system. An inefficient secondary market also means banks have less capital to make additional loans to meet their customers' needs.

[1] The American Bankers Association is the voice of the nation's $18 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard nearly $14 trillion in deposits, and extend more than $10 trillion in loans.
[2] Notice of Proposed Rulemaking, Federal Interest Rate Authority, 84 Fed. Reg. 66,845 (proposed Dec. 6, 2019), https://www.govinfo.gov/content/pkg/FR-2019-12-06/pdf/2019-25689.pdf [hereinafter, Proposed Rule].

Congress understood that banks depend upon a stable, predictable, and consistent legal framework to operate efficiently and in a safe and sound manner. Congress amended the Federal Deposit Insurance Act (FDI Act) to add section 27 in order to vest in state banks the power to charge interest on a loan at the maximum rate permitted in the state where the bank is located.[3] That power permits state banks to avoid the negative consequences that would result from requiring banks to comply with multiple, and ever-charging, state usury laws.

Section 27 is patterned after the National Bank Act (NBA) and, under the canons of statutory construction, the two statutes are to be interpreted in the same way.[4] The NBA permits a national bank to "charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located," regardless of the presence of a usury cap in the state where the borrower resides or where any collateral is located.[5] The courts and Federal banking agencies have long concluded that section 27 and the NBA preempt the application of state usury laws to loans originated to state banks and national banks, regardless of whether the loan is held by the bank or sold to another party.[6] Preemption of state usury laws provides the legal certainty necessary for credit markets to function efficiently, allowing banks and loan purchasers to diversify their assets efficiently and facilitating borrowers' access to credit.

However, in 2015 the U.S. Court of Appeals for the Second Circuit's decision in *Madden v. Midland Funding, LLC* undermined the "valid-when-made" doctrine.[7] The court held that the NBA does not preempt the application of state usury laws to a loan originated by a national bank when that loan is sold to a party that is not a national bank.[8] By calling into question the "valid-when-made" doctrine, the decision has injected uncertainty into the primary and secondary markets for consumer and commercial credit, including for loans originated by state banks. When loans cannot be resold by lenders, or the ability to do so is substantially curtailed, credit availability decreases and borrowers' costs rise.

ABA supports the FDIC's decision to codify its longstanding position that when a bank sells, assigns, or otherwise transfers a loan, all contractual terms of the loan remain enforceable after the transfer. The Proposed Rule would strengthen the primary and secondary loan markets, protect the ability of banks and loan purchasers to diversify against risk, encourage the origination of new loans, and promote borrowers' access to credit.

To ensure that the Proposed Rule achieves the FDIC's objective to codify the "valid-when-made" doctrine, we urge the FDIC to continue to coordinate its work on this rulemaking with the Office of the Comptroller of the Currency (OCC), which also issued a proposed rule to confirm

[3] *See* Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), Pub. L. No. 96-221, § 521, 94 Stat. 132, 165 (1980).
[4] See footnotes 11-12 and accompanying text.
[5] 12 U.S.C. § 85.
[6] See footnotes 15 and 17 and accompanying text.
[7] *Madden v. Midland Funding, LLC*, 786 F. 3d 246 (2d Cir. 2015).
[8] *Id.* at 251.

the doctrine as applied to national banks and Federal savings associations.[9] It is imperative that the two agencies' regulations are aligned as much as possible, so that courts do not conclude that the meaning of the two regulations differ.

II. The Proposed Rule Affirms Congress' Intent to Provide State Banks with the Power to Export the Interest on their Loans

Section 27 of the FDI Act grants state banks the authority to charge interest on a loan at the "rate allowed by the laws of the State . . . where the bank is located . . . ."[10] This statutory language is patterned after section 85 of the National Bank Act, which provides that a national bank may charge interest on a loan "at the rate allowed by the laws of the State . . . where the bank is located."[11] As the FDIC recognized, the two statutory provisions should be read *in pari materia* — i.e., interpreted in the same way.[12] Indeed, Congress passed section 27 to "prevent discrimination" against state banks[13] and to provide "competitive[] equality"[14] with respect to the authorities of national and state banks to make loans and export the interest rate on those loans.

Turning to the NBA, Congress passed the statute to permit national banks to operate across state lines without being hindered by differing state laws.[15] To advance this objective, the NBA vests in national banks enumerated powers and "all such incidental powers as shall be necessary to carry on the business of banking."[16] These "powers" indisputably include the power to originate, sell, and purchase loans.[17] It is well established that the NBA preempts any application of state

---

9 *See* Notice of Proposed Rulemaking, Permissible Interest on Loans that Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64,229 (proposed Nov. 21, 2019). ABA commented on, and expressed support for, the OCC's proposed rule. *See* Letter from Jonathan Thessin, Am. Bankers Ass'n, to Office of the Comptroller of the Currency (Jan. 21, 2020), https://www.aba.com/advocacy/policy-analysis/proposed-rule-to-codify-valid-when-made-principle.

10 12 U.S.C. § 1831d.

11 *Id.* § 85; *see Gavey Properties/762 v. First Fin. Sav. & Loan*, 845 F.2d 519, 521 (5th Cir. 1988) ("Congress . . . enact[ed] substantially identical language in . . . Sec. 1831d . . . to that found in 12 U.S.C. Sec. 85 . . . .").

12 *See* Proposed Rule, 84 Fed. Reg. at 66,845; *Greenwood Trust Co. v. Mass.*, 971 F.2d 818, 826 (1st Cir. 1992) ("The historical record clearly requires a bank to read the parallel provisions of [section 27] and the [National] Bank Act *in pari materia*.") (emphasis in original).

13 12 U.S.C. § 1831d.

14 126 Cong. Rec. 6,900 (1980) (statement of Sen. Proxmire (D-WI); *see also* 126 Cong. Rec. 6,907 (1980) (observing that section 27 will "allow[] competitive equity among financial institutions, and reaffirm[] the principle that institutions offering similar products should be subject to similar rules"); *Greenwood Trust Co.*, 971 F.2d at 826 ("Congress tried to level the playing field between federally chartered and state-chartered banks when it enacted" the DIDMCA, which added section 27 to the FDI Act).

15 *See Easton v. Iowa*, 188 U.S. 220, 229 (1903) (observing that Congress intended for national banks to be "independent . . . of state legislation which, if permitted to be applicable, might impose limitations and restrictions" on banks that are "as various and as numerous as the states"); *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10 (2003) (quoting *Tiffany v. Nat'l Bank of Mo.*, 85 U.S. 409, 412 (1873)) (concluding that the NBA provides national banks with "protection from 'possible unfriendly State legislation.'").

16 12 U.S.C. § 24 (Seventh).

17 *Id.* § 371 (granting national banks the power to "make, arrange, purchase or sell loans"); *see* 12 C.F.R. § 7.4008(a) (OCC regulations confirm that national banks may "make, sell, purchase, participate in, or otherwise deal in loans"

law that would "curtail or hinder a national bank's efficient exercise of [its] power, incidental or enumerated, under the NBA."[18] When state laws "significantly impair" the exercise of one of the bank's powers, "the State's regulations must give way."[19]

In patterning section 27 after the NBA, Congress gave state banks identical authority to operate across state lines without impairment from differing state laws.[20] As described above, section 27 permits a State bank to "charge on any loan . . . interest . . . at the rate allowed by the laws of the State . . . where the bank is located," regardless of the presence of a usury cap in the state where the borrower resides or where any collateral is located.[21] Indeed, for a bank to make loans efficiently, it must be permitted to sell its loans to other parties and for each loan to be enforceable according to its contractual terms, regardless of any conflicting state law where the purchaser is located. The Federal banking agencies have long concluded that if the terms of a loan made by a bank may change when the loan is sold on the secondary market, the loan's marketability would be impacted, and the bank's power to make the loan in the first place would be constrained.[22]

However, in *Madden*, the Second Circuit cast doubt on the ability of national banks — and, by extension, state banks — to export the interest on a loan when assigning that loan to another party. In its decision, the court incorrectly held that the NBA's preemption extends only to

---

without regard to state-law restrictions); *id.* § 34.3(a) ("A national bank may make, arrange, purchase, or sell loans or extensions of credit" that are backed by real estate). Moreover, for over 170 years, it has been well established that the power of a bank to originate loans, irrespective of its charter, includes the power to sell those loans. *See Planters' Bank of Miss. v. Sharp*, 47 U.S. 301, 323 (1848).

[18] *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12-13 (2007).

[19] *Id.* at 12.

[20] In 1997, Congress passed the Riegle-Neal Amendments Act, which provided that the laws of a host state apply to branches of an interstate state bank located in another state "to the same extent" as such laws apply to the branches of a national bank located in another State. Riegle-Neal Amendments Act of 1997, Pub. L. 105-24, § 2(a), 111 Stat. 238, 238 (1997) (amending section (j) of the Federal Deposit Insurance Act). This law further demonstrates Congress' intent that state banks have identical authority as national banks to operate across state lines without impairment from differing state laws.

[21] 12 U.S.C. § 1831d.

[22] *See* U.S. Dep't of the Treasury, Office of Thrift Supervision, Opinion Letter No. P-2003-5, Preemption of New Jersey Predatory Lending Act 7 n.18 (2003) (observing "the general principle 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"); *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), http://archives-financialservices.house.gov/media/pdf/012804jw.pdf (concluding that "localized and State-based restrictions on loan terms substantially affect the marketability of such loans, and that, in turn, affects overall credit availability to credit-worthy consumers"); *cf. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. at 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 banks and their agents and subsidiaries, and not to other parties that may purchase the loan.

The *Madden* court's narrow and flawed understanding of the NBA contravenes the purposes of the statute and the substantial body of case law interpreting it. If a non-usurious loan originated by a bank may become usurious once transferred to a non-bank purchaser — as *Madden* holds — the bank's loan origination and sale operations would be "significantly impaired."[23]

We agree with the FDIC that "*Madden* has created uncertainty regarding the enforceability of loans originated and sold by state banks."[24] Indeed, *Madden* has disrupted the secondary market for loans originated by banks and for interests in loan securitizations, impaired the ability of banks to originate loans, and reduced credit access, particularly for lower-income borrowers, as described below in Part III of our comment letter. The Proposed Rule would reverse these negative outcomes for state banks and affirm the objective of section 27 to provide parity between national and state banks.

III. *Madden* Has Detrimentally Impacted the Secondary and Primary Markets for Bank Loans

After the *Madden* decision, potential purchasers of loans and interests in loan securitizations face the risk that a loan that was valid at origination may be ruled invalid after the transfer if the purchaser is located in a state with a usury limit that is lower than the interest rate on the loan. As described below, available evidence indicates that this increased risk has detrimentally affected the secondary loan market in the states under the Second Circuit's jurisdiction and has discouraged lending by banks in those states.

Insurance companies, asset managers, private equity funds, and other nonbank entities purchase loans from national banks (and other banks) to balance their portfolios and manage risk. Under *Madden*, these purchasers face the risk that a loan they purchase could be ruled invalid, eliminating the value of the asset. To mitigate this risk, potential purchases may feel compelled to conduct a costly and inefficient loan-by-loan assessment to determine whether each loan's interest rate exceeds the cap in the state where the purchaser is located. Even after conducting this assessment, a purchaser cannot eliminate entirely the risk of purchasing a voidable loan because the purchaser may not be able to foresee all venues where a plaintiff could bring an action to challenge the loan's validity.

Madden's disruption of the secondary market also impairs the ability of banks to operate in a safe and sound manner. It is critical that banks are able to maintain proper levels of liquidity. The ability to securitize or sell loans allows banks to increase their liquidity and provide credit to their communities. The Proposed Rule will make banks' loans more marketable, enhancing their ability to diversify against risk and to comply with risk-based capital and liquidity requirements.

---

[23] *See Watters*, 550 U.S. at 12.
[24] Proposed Rule, 84 Fed. Reg. at 66,845.

The *Madden* decision also reduces banks' incentive to originate loans. If a bank believes that it cannot sell a loan on the secondary market, it will be less likely to make the loan. *Madden* particularly discourages banks from making loans to higher-risk borrowers, who have less access to credit. One study found that the *Madden* decision significantly reduced the price of notes backed by loans that were made to borrowers in the States of Connecticut and New York at interest rates that exceeded those states' usury caps.[25] In addition, the study found that lenders responded to *Madden* by extending relatively less credit to higher-risk borrowers in these two states — i.e., borrowers who traditionally have less access to credit.[26] Similarly, another study found that *Madden* has led to a reduction in credit access for low-income households in Connecticut and New York.[27] The study also found that the total number of personal bankruptcy filings was 8% higher in Connecticut and New York relative to the states in the study's control group, during the two years after *Madden* was decided.[28] In sum, low-income borrowers have less access to credit in these two states and, as a result, file for bankruptcy more frequently.

The response to *Madden* by one ABA member, a state-chartered community bank headquartered in Delaware, underscores the decision's impact on bank lending. The bank sought to cease lending to consumers and businesses located in New York State after July 2015 (two months after *Madden* was decided). Prior to *Madden*, loans made to New York residents and businesses constituted approximately 16% of the bank's originations; one year after *Madden*, in May 2016, that percent had dropped to 5%. The bank estimates that it did not originate $52 million worth of loans because of *Madden*.[29]

IV. The Proposed Rule Reverses *Madden*'s Harmful Consequences

The Proposed Rule would reverse *Madden*'s negative effects on the secondary and primary markets for loans, and prevent other courts from adopting a legal standard modeled after *Madden*. The Proposed Rule provides that a state bank "may, notwithstanding any State constitution or statute which is preempted by section 27 . . . charge on any loan . . . interest . . . at

[25] Colleen Honigsberg, Robert J. Jackson, Jr., & Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, J. L. & ECON 3 (forthcoming 2017), https://ccl.yale.edu/sites/default/files/files/LEO18_Honigsberg.pdf. Connecticut and New York have usury caps of between 6% and 12%. *See* Conn. Gen. Stat. § 37-1 & 37-4 (2019) (absent a written agreement, the maximum interest rate is 8% per year, and loans at an interest rate above 12% are prohibited); NY CLS Gen. Oblig. § 5-501 et seq. (interest rate on a loan generally is 6% per year).

Usurious loans are void in Connecticut and New York, but they remain valid in Vermont, where the borrower is excused only from paying interest above the permissible rate. Because of these differing laws, the researchers did not include loans made in Vermont in the group of loans that the researchers compared against the control group of loans made outside of the Second Circuit. Honigsberg et al., *supra*, at 16-17.

[26] *Id.* at 21-22.

[27] Poitr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* 3 & 22 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208908 (subscription required).

[28] *Id.* at 3 & 21.

[29] This assumes that loans made by the bank to New York borrowers would continue to represent 16% of the bank's originations.

the rate allowed by the laws of the State . . . where the bank is located . . . ."[30] The Proposed Rule further provides that "[w]hether interest on a loan is permissible under section 27 . . . is determined as of the date the loan was made."[31]

This language confirms the longstanding and settled understanding of the "valid-when-made" doctrine that when a loan is valid when it is made, the loan is enforceable according to its contractual terms upon the sale, assignment, or transfer of the loan to another party. The FDIC should act without delay to finalize this rule.

V. The FDIC Has Legal Authority to Issue a Rule to Implement Section 27 of the Federal Deposit Insurance Act

The Supreme Court's seminal decision in *Chevron v. Natural Resources Defense Council* is clear: if a statute is "silent or ambiguous" about the "precise question at issue," then a reviewing court should give "considerable weight" to an agency's construction of a statutory scheme it is entrusted to administer.[32] Those circumstances are present here. As described above, Congress passed section 27 of the FDI Act to preempt state laws that significantly interfere with a state bank's ability to exercise its powers and to provide parity between the powers of national banks and state banks to set and export interest rates on loans.[33] Those powers indisputably include the power to make or sell loans.[34] As described in greater detail above, the *Madden* decision allows state usury laws to interfere significantly with these powers of a bank, including state banks. The Proposed Rule will restore core banking powers by providing legal certainty to state banks that a loan that was valid at origination will remain valid after the sale, assignment, or transfer of the loan. As the FDIC states in the proposal, "[l]oan sales enable State banks to increase their liquidity in a crisis, to meet unusual deposit withdrawal demands, or to pay unexpected debts."[35] As described above, if the terms of a loan made by a bank may change when the loan is sold on the secondary market, the loan's marketability would be impacted, and the bank's ability to make the loan in the first place would be impaired. This would constrain banks from obtaining needed capital and from diversifying against risks associated with concentrated lending in particular market segments.

These adverse effects impair a bank's ability to conduct its business in a safe and sound manner. The FDIC has ample authority under the FDI Act to prevent this result from occurring. A court reviewing the final rule would be compelled to uphold the rule as a valid exercise of the FDIC's powers.

---

[30] Proposed Rule, 84 Fed. Reg. at 66,853.
[31] *Id.*
[32] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-44 (1984).
[33] *See supra*, Part II.
[34] *See Planters' Bank of Miss.*, 47 U.S. at 323.
[35] Proposed Rule, 84 Fed. Reg. at 66,845.

VI. The FDIC Should Continue to Coordinate Its Rulemaking with the Office of the Comptroller of the Currency

As the FDIC is aware, the Office of the Comptroller of the Currency (OCC) also has proposed a rule to affirm the "valid-when-made" doctrine for national banks. We encourage the FDIC to continue to coordinate with the OCC as each agency finalizes its respective proposals. As discussed above, the Federal statutory provisions in the FDI Act that preempt application of state usury laws to loans originated by state banks are "patterned after, and have been interpreted consistently with, section 85" of the National Bank Act.[36] Coordination between the two agencies is critical to ensure that the courts do not impose standards for FDI Act preemption that differ from the standards established for NBA preemption.

Conclusion

ABA supports the Proposed Rule. The proposal would restore the efficiency and effectiveness of the primary and secondary markets for loans, particularly in the Second Circuit. This would protect the ability of state banks and loan purchasers to diversify when their holdings become concentrated and facilitate the origination of new loans, expanding borrowers' access to credit.

Sincerely,

Jonathan Thessin
Senior Counsel
Consumer & Regulatory Compliance
Regulatory Compliance and Policy

[36] *Id.* at 66,846.