CSBS SINCE 1902
CONFERENCE OF STATE BANK SUPERVISORS

February 4th, 2020

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AF21

Re: *Federal Interest Rate Authority.*

Dear Sir or Madam,

The Conference of State Bank Supervisors ("CSBS")[1] appreciates the opportunity to comment on the Notice of proposed rulemaking issued by the Federal Deposit Insurance Corporation (the "FDIC") titled "Federal Interest Rate Authority". The proposed rule would, in addition to codifying several long-standing interpretations regarding state banks' federal interest rate authority, provide that whether interest on a loan is permissible under section 27 would be determined at the time the loan is made, and would not be affected by subsequent events, including the sale, assignment, or other transfer of the loan. CSBS appreciates the need to provide greater clarity and certainty to assignees of loans made by state banks. However, we also believe that the proposed rule should not interfere with state law rights and remedies to a greater extent than necessary to achieve this intended policy objective.

As explained below, CSBS believes the proposed rule would ultimately provide greater certainty for industry as well as consumers and regulators by addressing the legal implications of the proposal with respect to rights and remedies afforded under federal and state law. Specifically, CSBS recommends that the FDIC clarify and revise the proposed rule to ensure that its impact on state law rights and remedies—including the true lender doctrine and other state law requirements—does not exceed the stated intention of the proposed rule. We also request that the FDIC address how the proposed rule would interact with the right of states to opt out of federal interest rate authority. CSBS believes that these recommendations, if adopted, will ensure that the proposed rule provides the clarity and certainty intended while also ensuring that it does not interfere with important consumer protections traditionally afforded under state law.

Introduction

The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) added a new section 27 to the Federal Deposit Insurance Act to grant all federally-insured financial institutions—State banks, savings associations, and credit unions—similar interest rate authority to that provided to national banks. In enacting DIDMCA, Congress intended to promote competitive equality in the nation's banking

[1] CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.

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system by providing parity between federally-chartered and state-chartered institutions with respect to federal limits on interest rates. Congress made its intention to promote competitive equality evident both in the language of section 27 as well as by patterning after section 85 of the National Bank Act.

Since its enactment, the FDIC has, in interpreting section 27, sought to fulfill the purpose of providing competitive equality, including by extending elements of federal interest rate authority to state banks such as the most favored lender doctrine, interest rate exportation, and the federal definition of interest. The proposed rule would codify these interpretations by promulgating regulations patterned after the equivalent regulations applicable to national banks.

In addition to codifying these long-standing interpretations, the proposed rule would establish a new interpretation to provide that the permissibility of interest under section 27 is determined when a loan is made, and is not affected by later events such as a change in State law or the sale, assignment, or other transfer of the loan. Clarifying the right of assignees to enforce interest rate terms in state bank loans is said to be necessary because "[t]he decision of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC* has 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."

In *Madden*, the court concluded that the preemption afforded by section 85 of the NBA does not apply to third-party nonbank assignees of loans made by national banks because application of state usury law to the nonbank assignee "would not significantly interfere with any national bank's ability to exercise its powers under the [NBA]."[2] Although the decision did not apply to state banks, because section 27 is patterned after and interpreted in the same manner as section 85, the proposed rule reasons that *Madden* also has created uncertainty regarding the enforceability of loans originated and sold by state banks.

CSBS appreciates the need to provide greater certainty as to the ability assignees to enforce interest rate provisions of loans originated by national banks. We agree that the ability of banks to assign loans is an important tool to manage liquidity and ensure safety and soundness. Additionally, there are many legitimate and beneficial financial arrangements that involve loan assignment, such as securitization and debt collection. To the extent that the *Madden* ruling has created uncertainty as to the ability of banks to engage in these legitimate arrangements, CSBS believes that that uncertainty should be reduced.

However, we also believe that the FDIC should not address concerns regarding uncertainty in a manner which will interfere with state law consumer protections to a greater extent than necessary to provide the certainty intended. As explained below, we are concerned that, absent further revision, the proposed rule may be used to interfere with the state law rights and remedies in a manner which is neither intended by the proposal or necessary to achieve greater certainty. Additionally, we believe that further clarity is warranted regarding how the proposed rule interacts with the opt-out authority of states under section 27.

I. The proposed rule should preserve, not preempt, rights and remedies afforded under state consumer protection laws, including the true lender doctrine.

While the proposed rule is intended to address concerns regarding uncertainty arising from the *Madden* decision, it states that it is not intended to impact other recent litigation which deals with the related, but distinct legal question regarding the so-called true lender doctrine. Specifically, the proposed rule states that "[t]he regulations do not address the question of whether a State bank or insured branch of a foreign

[2] *Madden v. Midland Funding, LLC*, 786 F.3d 246, 249 (2nd Cir. 2015).

bank is a 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.'"

CSBS appreciates the intent to preserve the true lender doctrine because it is an important remedial tool afforded by state law. The doctrine is utilized in cases in which a nonbank enters into a lending arrangement with a bank to obtain the benefits of interest rate exportation and evade otherwise applicable state consumer protection laws. In these arrangements, the nonbank typically markets the loan, makes all the credit decisions and directs its bank-partner to originate its loans only to purchase them from the bank within days. To challenge these arrangements, consumers and state officials have brought claims against the nonbank partner asserting that, although the bank is the nominal lender, the nonbank is the true lender and cannot evade applicable state usury and consumer protection laws.

In reviewing these claims, courts have applied the true lender doctrine by reviewing the substance of the arrangement in light of the totality of the circumstances to determine whether the nonbank has the predominant economic interest in the loan. The essential feature of the doctrine is its heavy reliance on a fact-intensive, totality-of-the-circumstances analysis conducted by courts. The role of courts in reviewing the substance, rather than the form, of these nonbank lending arrangements is essential because courts are uniquely capable of identifying, *ex post,* the real incentives of the parties without regard to the obfuscating names or forms and molding the shape of the doctrine to forestall attempted circumvention.

To be clear, we commend the FDIC for its support for "the position that it will view unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s)." However, the FDIC's supervisory role in reviewing third party lending arrangements to prevent unsafe and unsound practices on an *ex ante* basis should not displace the role of courts and state officials reliance on the true lender doctrine to remediate harm on an *ex post* basis. Rather, these regulatory and judicial authorities should be exercised concurrently and independently—just as they were before and after the *Madden* decision.

Lastly, CSBS believes the true lender doctrine should be preserved as a state law remedy in light of federalism principles. Issues of credit affordability and access are inherently local concerns which are best balanced at the state and local level given the wide variation in the financial circumstances across the country. For this reason, it is important for consumers to maintain control over the rates, terms and conditions at which credit is offered in their state.

Allowing a nonbank to evade otherwise applicable interest rate caps interferes with the ability of consumers, as citizens, to strike the desired balance between credit access and affordability. The true lender doctrine is an important tool that consumers can rely on to prevent such interference. Thus, CSBS would not support the proposed rule to the extent it results in the preemption of true lender claims and prevents consumers, as citizens, from maintaining control over their economic lives through the medium of state regulation.

II. The FDIC should revise the proposed rule to preserve rights and remedies afforded under state law, including the true lender doctrine.

While we appreciate the FDIC clarifying its intention not to preempt the true lender doctrine, CSBS believes it would be preferable for this intention to be reflected in the text of the proposed regulation itself. This is particularly important to ensure that the rule is not used in a manner that exceeds the FDIC's stated intent (i.e. to circumvent the state law true lender doctrine). Just because the FDIC does not intend for the proposed rule to provide which entity is the true lender, this intention does not foreclose a nonbank third party from using the proposed rule in an attempt to defeat a true lender claim brought by a consumer or state official.

This concern is particularly acute in the case of the proposed rule because, in certain respects, it would seem to have a somewhat broader impact relative to the OCC's proposed rule. Specifically, by establishing a rule for the time at which the permissibility of interest under section 27 should be determined, the rule federalizes a rule that is traditionally a matter of state common law. In doing so, the proposed rule may unintentionally circumscribe judicial discretion and agility to animate the public policy reflected in relevant state law.

Accordingly, we request that the FDIC amend and revise the proposed regulation to narrow its scope and add a proviso to preserve the remedies afforded consumers and state officials under the true lender doctrine. First, the FDIC should narrow the scope of the proposed rule by providing only that interest on a loan that is permissible under section 27 shall not be affected by the sale, assignment, or other transfer of the loan rather than providing that permissibility shall not be affected by any subsequent events and listing events other than the sale, assignment, or transfer of the loan. Eliminating references to these other events will not reduce the certainty provided by the rule because these rules are already widely accepted common law principles regarding retroactive application and address questions beyond those raised in *Madden*.[3]

Second, we request that the FDIC insert into the proposed regulation a proviso to preserve the remedies afforded consumers and state officials under the true lender doctrine. For instance, the proposed regulation could be revised to provide that the permissibility under section 27 of the FDIA of interest on a loan shall not be affected by the sale, assignment, or other transfer of the loan "provided that the entire circumstances of the transaction show that the purchaser, assignee, or transferee is not the true lender of the loan under the law of the state in which the borrower resides."

Adding this proviso should ensure that the continued enforceability of the interest term by nonbank assignees does not apply in those arrangements in which the nonbank, rather than the bank, has the predominant economic interest in the loan and thus is the true lender. Providing that the relevant state law is the law of the state in which the borrower resides preserves the ability of consumers, as state citizens, to some control over the provision of credit in their state.

Ultimately, CSBS seeks to ensure that the rule limits the application of the valid-when-made principle to circumstances in which the bank is, in fact, the true lender so that (1) state law true lender claims remain viable, (2) the relevant state law remains the law of the state in which consumer resides and (3) the traditional role of courts in making this determination is preserved. Since different language could be employed to achieve these goals, state regulators are willing to consult with the FDIC, as well as the OCC, regarding any amendments and revisions to the proposed rule.

It is worth noting that adopting the recommended proviso would not interfere with the objective of restoring certainty and returning to the pre-*Madden* status quo. As the OCC has previously noted, the valid when made principle is a common law doctrine and thus, if it existed pre-*Madden*, it had to be incorporated into state law.[4] Moreover, the origins of the true lender doctrine predate the *Madden*

[3] *See 44B Am Jur 2d Interest and Usury* § 8 ("[A] subsequent statute affecting the rate of interest recoverable will not ordinarily apply when there is an existing contractual obligation, express or implied, fixing the rate of interest.").
[4] *See* Brief for United States as amicus curiae, *Midland Funding, LLC v. Madden* (No. 15-610), at 20 ("More generally, the practical importance of the preemption issue presented in this case depends significantly on the extent to which individual States decline to incorporate the valid-when-made rule into their own usury laws. Petitioners

decision, so any uncertainty created thereby was very much a part of the pre-*Madden* status quo.[5] Given that adding a true lender proviso would not interfere with intended objective of the proposed rule, CSBS urges the FDIC to revise the proposed rule text in order to solidify its intention to preserve the rights and remedies afforded under the true lender doctrine.

III. The FDIC should clarify that the proposed rule does not affect the applicability of state licensing requirements as well as how the proposed rule interacts with states opt-out authority under section 27.

In addition to revising the proposed rule, CSBS requests that, in describing the proposed rule, the FDIC clarify that the proposed rule does not impact other state law requirements applicable to nonbank assignees. In particular, the FDIC should clarify that the ability of assignees of bank loans to enforce the loan's interest rate terms does not relieve the nonbank assignee of its obligation to obtain applicable license(s) in the state in which the consumer resides.

Along with seeking to evade usury laws, nonbanks have relied on partnerships with banks in an attempt to avoid applicable state licensing requirements. State regulators devote significant resources to policing unlicensed activity and we believe the federal agencies should avoid taking action which may create confusion as to the continued applicability of state licensing requirements. For this reason, CSBS urges the FDIC to clarify that the proposed rule does not affect the applicability of otherwise applicable licensing requirements to nonbank assignees of state bank loans.

Lastly, CSBS requests clarity as to how the proposed rule interacts with states opt-out authority under section 27. As acknowledged in the proposal, the FDIA provides that states may opt out of the coverage of section 27. This opt-out authority is exercised by adopting a law, or certifying that the voters of the state have voted in favor of a provision which states explicitly that the state does not want section 27 to apply with respect to loans made in such state.

Although the proposed rule acknowledges the state opt-out authority, it does not address how the proposed rule (including the provisions codifying existing interpretations of section 27) would interact with this authority. Accordingly, CSBS requests that, in describing the proposed rule, the FDIC clarify how it would be impacted by and/or impact the opt-out authority afforded states under section 27.

Conclusion

CSBS appreciates the opportunity to comment on the proposed rule. Given the importance of loan assignment for safety and soundness and certain legitimate financial arrangements, we appreciate the intention to provide greater clarity and certainty to assignees of state bank loans regarding the permissibility of the interest rates. While, as explained above, we appreciate the stated intention not to interfere with the true lender doctrine, we believe this intention should be reflected in the proposed regulation itself and also that clarity should be provided regarding the impact on other state consumer protection laws and federal laws. CSBS and state regulators are willing to consult further with the FDIC as well as the OCC as the agencies consider how to proceed with the proposed rulemaking.

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have made no effort to demonstrate that state-law departures from the valid when-made rule have been widespread. For this reason, as well, the Court's review is not warranted at the present time.").

[5] *See generally* John Hannon, *The True Lender Doctrine: Function Over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 Duke L.J. 1261 (2018).

Sincerely,

John Ryan