February 4, 2020

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

Re: Federal Interest Rate Authority, RIN 3064-AF21

Dear Mr. Feldman:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Federal Deposit Insurance Corporation ("FDIC"), regarding permissible interest rates on loans sold to non-banks.

The Release explains that it was issued to remove uncertainties potentially created for state-chartered banks and insured branches of foreign banks ("state banks") by a Second Circuit decision that fortified the application of consumer protection laws—specifically state usury laws—to non-banks, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

Unfortunately, the Release is flawed in three major respects, rendering it unlawful and arbitrary and capricious.

- First, it appears to exceed the scope of the FDIC's legal authority by addressing the rights of **non**-state banks—unaffiliated in any way with a state bank—engaged in purchasing and collecting on consumer loans.

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 84 Fed. Reg. 66,845 (Dec. 6, 2019).

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- Second, it offers no concrete evidence whatsoever to support the claim that the decision in *Madden* has created genuine and harmful uncertainty in the market for bank loans or that any such uncertainty has "significantly interfered" with any operations of any state bank, any exercise of any state bank's powers, or liquidity in the credit markets. On the contrary, the Release actually states that the FDIC is unaware of "*any* widespread or negative effects on credit availability or the securitization markets" as a result of the *Madden* decision.[3]

- Finally, the Proposal fails even to mention or address the ominous threat to consumers that it poses. By proposing to immunize non-bank entities from state usury laws when they purchase loans outright from state banks, the Proposal will pave the way for unscrupulous loan sharks, payday lenders, and other predatory enterprises to partner with a state bank to gouge vulnerable borrowers with enormous interest rates with impunity—regardless of the protections that the borrower's home state determined were appropriate or necessary. The Release actually reveals the FDIC's apparent desire to facilitate rent-a-bank schemes by claiming that by virtue of the Proposal, such arrangements will *benefit* consumers by affording them greater access to credit—a classic attempt to portray harmful deregulation as a boon to consumers.

We urge the FDIC to withdraw the Proposal and re-release it, if at all, only after addressing all of the foregoing issues in detail by explaining the scope of its legal authority to issue such a Proposal; by justifying the Proposal, if possible, with thoroughly documented and credible evidence and analysis; and by forthrightly addressing the alarming implications and risks that the Proposal poses for countless borrowers in the credit market.

BACKGROUND AND SUMMARY OF THE PROPOSAL

Section 27 of the Federal Deposit Insurance Act provides, in pertinent part, that a state bank may charge the rate of interest "allowed by the laws of the State, territory, or district where the bank is located."[4] Section 27 is modeled after Section 85 of the National Bank Act[5] and accordingly has been construed by courts in the same manner as Section 85.[6] In turn, court decisions have expanded Section 85, so that a national bank located in a state that allows high interest rates and fees can charge the residents of any other state those same interest rates and fees, even if they would be illegal in the borrower's home state. This privilege has been expanded to

[3] Release at 66,851.
[4] 12 U.S.C. 1831d(a).
[5] Section 85 of the National Bank Act provides that a national bank may "charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85.
[6] Release at 66,847.

include charges that are not strictly interest, such as late charges, and it also extends to the operating subsidiaries of the national bank.[7]

Essentially, courts applying Section 85 have held that state usury laws are pre-empted with respect to national banks that charge interest or fees that are permissible under federal law, and with Section 27 of the Federal Deposit Insurance Act, Congress essentially has expanded this ability to export interest rates to *state* banks.

In 2015, the Second Circuit issued its decision *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). In *Madden*, FIA Card Services, N.A. ("FIA"), a national bank, issued a credit card to Madden, a New York resident. FIA charged an interest rate on Madden's credit card that would have been usurious under New York state law, but for the fact that FIA was a national bank. After FIA charged off the account, it sold the loan to Midland Funding LLC ("Midland"), which then attempted to collect the debt, purporting to charge the same interest rate as FIA (27%), which again was usurious according to New York law. Madden sued, alleging that Midland was charging an illegal interest rate under New York law. The Second Circuit held that New York's usury law was not preempted as to Midland, because: (1) Midland was not a national bank, (2) Midland was not affiliated with FIA, and (3) FIA retained absolutely no interest in the account. Therefore, application of New York's usury law did not interfere with the powers of a national bank, because no national bank was involved in the loan after it was sold.

The court in *Madden* was careful to acknowledge cases holding that some non-bank entities may be permitted to invoke preemption of state law, but only if they are acting on behalf of national banks, as in the case of agents or operating subsidiaries.[8] Ultimately, the test is whether application of state law to the activities of such non-banks would "significantly interfere with a national bank's ability to exercise its power under the NBA."[9] The court held that a third-party debt collector that has purchased a national bank loan outright is acting on its own behalf, not on behalf of the national bank, and that applying state usury laws to such entities would not "significantly interfere" with the exercise of the national bank's powers:

> The defendants did not act on behalf of BoA or FIA in attempting to collect on Madden's debt. The defendants acted solely on their own behalves, as the owners of the debt. No other mechanism appears on these facts by which applying state usury laws to the third-party debt buyers would significantly interfere with either national bank's ability to exercise its powers under the NBA. *See Barnett Bank,* 517 U.S. at

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7 *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007); *Smiley v. Citibank (S. Dakota), N.A.,* 517 U.S. 735, 740 (1996); *Marquette Nat. Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 312 (1978)

8 *Madden*, 786 F.3d at 250-51.

9 *Id.* at 250.

> 33, 116 S.Ct. 1103. Rather, such application would "limit [ ] only activities of the third party which are otherwise subject to state control," *SPGGC, LLC v. Blumenthal,* 505 F.3d 183, 191 (2d Cir.2007), and which are not protected by federal banking law or subject to OCC oversight.[10]

In the Proposal, the FDIC essentially seeks to reverse the Second Circuit's holding in *Madden* by providing that, if a state bank originates a loan and charges a permissible interest rate under the law of its home state, that interest rate remains permissible in all states, even if the loan is assigned to a non-national bank lender.

<u>COMMENTS</u>

1. **<u>The FDIC Fails to Explain the Legal Authority for Regulating the Permissible Interest Rates Applicable to Non-Banks.</u>**

The Proposal, which is in reaction to *Madden*, purports to provide clarity regarding state bank authority to charge particular interest rates and to assign contracts.[11] But *Madden* did not enlarge or restrict the authority of banks, national or state, to do anything. No bank was being sued in *Madden*, and the Second Circuit's opinion, by its terms, does not in any way regulate the conduct of banks. Moreover, the Proposal does not grant any additional power to state banks regarding interest rates or contract assignments that national banks do not already have. Instead, the Proposal purports to grant authority to **non-banks** to circumvent state usury caps.

In the Release, the FDIC justifies its approach of giving non-banks the benefit of pre-emption by claiming that "[u]ncertainty regarding the enforceability of interest rate terms may hinder or frustrate loan sales, which are crucial to the safety and soundness of State banks' operations for a number of reasons."[12] However, the FDIC provides no evidence for this speculative assertion, it merely claims that it is so.[13] And without any evidence providing a nexus between the *Madden* holding, any significant interference with the exercise of a state bank's powers, or any other negative impact on the banking system that might support preemption of the

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10 *Id.* at 251.

11 Release at 66,849.

12 Release at 66,845.

13 The FDIC also explains that it "seeks to maintain parity between national banks and State banks with respect to interest rate authority," citing the OCC's own analogous proposal that would undermine state usury laws. But for similar reasons, that proposal is flawed, both on legal and policy grounds. Better Markets, Comment Letter on Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred (Jan. 21, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Permissible_Interest_on_Loans_that_are_Sold_Assigned_or_Otherwise_Transfered.pdf.

application of state usury laws to non-banks, the Proposal appears to be beyond the FDIC's legal authority.[14]

2. The Lack of Evidence to Justify the Proposal Renders it Arbitrary and Capricious.

Similarly, the FDIC fails to offer any substantive policy justification for the Proposal. It is well-settled that when promulgating a rule, an agency "must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made," and that a rule is arbitrary and capricious if it fails to meet that test.[15] Here, the FDIC states that *Madden* has "created uncertainty" regarding banks' ability to utilize loan sales, which the FDIC states are necessary for banks to utilize a number of liquidity and risk management tools.[16]

But given that the *Madden* decision came out in 2015, one would expect the FDIC to offer some evidence that, in the intervening four years, the supposed "uncertainty" the court created has in fact impacted banks' ability to "maintain adequate capital and liquidity levels."[17] Yet the FDIC offers none whatsoever. Indeed, to the contrary, the FDIC, astonishingly acknowledges that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision."[18] It would be plainly arbitrary and capricious for the FDIC to finalize a Proposal that even it acknowledges would be in service of "solving" a problem that does not exist.

3. The FDIC's Failure to Consider the Potential Consumer Harm Also Renders the Proposal Arbitrary and Capricious.

The Proposal is also arbitrary and capricious because it "entirely failed to consider an important aspect of the problem." [19] Specifically, as the Second Circuit pointed out in *Madden:*

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14 The Release raises vague concerns about the impact of *Madden* on the securitization market. But it fails to offer any concrete data, evidence, or analysis on that issue. Moreover, even assuming those concerns had some merit, the Proposal would at a minimum be overbroad. For example, *Madden* involved charged off debt, which was almost certainly sold for pennies on the dollar. Accordingly, it is highly unlikely that Midland actually expected to collect anything close to the full amount of interest on the debt, and so highly unlikely that application of New York's statutory cap would have had anything to do with its decision to purchase the loan from the national bank. The application of state usury laws in the scenario in *Madden* therefore had little if any impact on the ability of the bank to sell or assign its loans. *Cf. Petersen v. Chase Card Funding, LLC*, No. 19-00741, slip op. at 4-5 (W.D.N.Y Jan. 22, 2020) (holding that state New York state usury laws are preempted with respect to assignment made in connection with securitization).

15 *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, (1983).

16 Release at 66,845; 66,851.

17 Release at 66,851.

18 Release at 66,850.

19 *State Farm Mut. Auto. Ins. Co.,* 463 U.S. at 43.

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> [E]xtension of NBA preemption to third-party debt collectors such as the defendants would be an overly broad application of the NBA. Although national banks' agents and subsidiaries exercise national banks' powers and receive protection under the NBA when doing so, extending those protections to third parties would create **an end-run around usury laws** for non-national bank entities that are not acting on behalf of a national bank.[20]

The court's concern is real. As the FDIC points out, so-called "marketplace lenders" frequently engage in transactions involving "a partnership in which a bank originates and immediately sells loans to a nonbank partner."[21] Under the Proposal, the nonbank, without being subject to the supervisory oversight applicable to state banks or their affiliates, would be free to violate the state's usury caps. As the FDIC well knows, this threat is hardly new, as the rise in such "rent-a-bank" schemes is well-documented, where non-bank financial enterprises—ranging from online lenders to payday loan sharks—piggyback on the charters of national or other banks who are exempt from state regulatory requirements (including the usury laws) that would otherwise apply to the non-banks. In essence, the Proposal, by design, renders state usury caps a nullity by allowing non-banks to violate all but the weakest existing caps with impunity, opening up huge opportunities for all manner of predatory payday lenders, loan sharks, and others to exploit vulnerable borrowers.

The Proposal entirely fails to address these real threats. Worse, rather than condemning this sort of arrangement, the Release appears to favor it. Indeed, the Proposal seems explicitly designed to assist rent-a-bank schemes, as the FDIC bemoans the possibility that *Madden* "could adversely affect the viability of that business model," referred to euphemistically as "marketplace lending," in which a nonbank buys access to a key benefit of a bank charter—preemption of state usury laws—while incurring none of the obligations associated with a bank charter. Although the Release includes perfunctory admonishments suggesting that the FDIC will "view unfavorably" the banks or entities that partner with each other for the "sole purpose" of evading low interest rate caps under state law, those cautionary notes appear to be mere window dressing.[22] The FDIC conspicuously fails to state what it would do about such partnerships, beyond the finger-wagging. Nor is it clear what authority the FDIC would have to address the issue with respect to any nonbank entities engaged in such arrangements.

The Release includes yet further evidence showing that in reality, the FDIC is seeking to facilitate rather than deter rent-a-bank schemes. In a classic attempt to portray harmful deregulation as a benefit to consumers, the Release argues that by virtue of the state preemption

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[20] Madden, 786 F.3d at 252.
[21] Release at 66,850.
[22] Release at 66,846; 66,850.

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arising from the Proposal, "consumers may benefit from the improved availability of credit from state banks"—which the Release concedes "may be at a higher interest rate than otherwise provided by relevant state law."[23] But the opportunity for consumers to be gouged by exorbitant interest rates at the hands of lenders or servicers protected from state usury laws under the Proposal is hardly a benefit.

Needless to say, having chosen to cast the Proposal in purely beneficial terms, the FDIC offers no remedies to mitigate its threatened harm or to ensure that the loophole it opens will not be abused. It expressly and completely side-steps the potential application of the "true lender" doctrine as a mitigant for the potential abuses that the Proposal would facilitate, and it devotes no consideration to other measures, such as federally-imposed interest rate caps in tandem with state limits. These omissions—and the FDIC's blind eye to consumer harm—are indefensible in an area so rife with abuse.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

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[23] Release at 66,850.

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