February 5, 2020

ATTORNEY GENERAL RAOUL CONDEMNS PROPOSAL THAT WOULD ALLOW PREDATORY LENDERS TO EXPLOIT CONSUMERS

Chicago — Attorney General Kwame Raoul, along with California Attorney General Xavier Becerra and New York Attorney General Letitia James, led a coalition of 24 states in submitting a comment letter opposing a proposal by the Federal Deposit Insurance Corporation (FDIC) to preempt state usury laws that regulate payday and other high-cost lending.

Usury laws prevent predatory lenders from taking advantage of consumers by charging high interest rates on loans. The FDIC's proposed regulations would enable predatory lenders to circumvent state usury laws through "rent-a-bank" schemes, in which banks act as lenders in name only, passing along their state law exemptions to non-bank payday lenders.

"Payday lenders make money by preying upon low-income residents, locking them into unaffordable high-cost loans and the resulting cycle of debt that is extremely difficult to escape," Raoul said. "States like Illinois have strengthened regulations over payday lenders, and the FDIC's proposal to allow those same lenders to hide behind banks will interfere with the work that has and continues to be done to protect our residents."

Payday loans are high-interest, short-term loans that must be paid in full when the borrower receives their next paycheck. Payday lending can trap lower-income people who do not otherwise have access to consumer credit in endless cycles of debt. According to the Pew Charitable Trusts, the average payday loan borrower earns about $30,000 per year, and about 58 percent have trouble meeting their monthly expenses. The average payday borrower is in debt for nearly half the year because they borrow again to help repay the original loan. The average payday borrower spends $520 per year in fees to repeatedly borrow $375.

States, including Illinois, historically have played a critical role in protecting consumers from predatory lending using rate caps, mandatory cooling off periods and payment plans to prevent an endless cycle of debt. While federal law provides a carve-out from state laws for federally regulated banks, state laws continue to protect residents from predatory lending by non-banks such as payday, auto title and installment lenders. The new regulations proposed by the FDIC would extend the Federal Deposit Insurance Act exemption for federally regulated banks to these non-bank debt buyers, a sharp reversal in policy that deliberately evades state laws targeting predatory lending.

In the comment letter, Raoul and the multistate coalition argues that the FDIC's attempt to extend preemption to non-banks conflicts with the Federal Deposit Insurance Act, exceeds the FDIC's statutory authority and violates the Administrative Procedure Act.

Illinois is a national leader in investigating and enforcing consumer protection violations against predatory lenders. The office has sued unlicensed payday lenders that were giving loans to Illinois consumers and reached a settlement with All Credit Lenders for selling products with hidden interest rates ranging from 350 to 500 percent. Last year, Attorney General Raoul submitted comments to the FDIC urging it to ensure that small-dollar loans comply with state laws that regulate high-interest, small-dollar loans and other abusive lending practices. Raoul also opposed the Consumer Financial Protection Bureau's proposed repeal of rules adopted in 2017 to protect consumers from excessive interest rates and other predatory practices.

Joining Raoul in filing the comment letter are the attorneys general of California, Colorado, Connecticut, the District of Columbia, Hawaii, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New Mexico, New York, North Carolina, Oregon, Pennsylvania, Tennessee, Vermont, Virginia, Washington and Wisconsin and the Hawaii Office of Consumer Protection.

February 4, 2020

VIA ELECTRONIC SUBMISSION

Jelena McWilliams
Chairperson
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

Re: Federal Interest Rate Authority (Docket No. FDIC-2019-0147-0001)

Dear Chairperson McWilliams:

On behalf of the 24 undersigned State Attorneys General (the "States"), we write to express our strong and bipartisan objections to a rule proposed by the Federal Deposit Insurance Corporation (the "FDIC") that would sanction one of the myriad schemes the financial services industry has devised to repackage usury and evasion of state usury laws as "innovations" deserving of special federal protection.[1] At stake are so-called "rent-a-bank" schemes, in which banks heavily regulated by federal agencies like the FDIC enter into relationships with largely unregulated non-bank entities for the principal purpose of allowing non-banks to evade state usury laws. Section 331.4(e) of the FDIC's proposed rulemaking (the "Proposed Permissible Interest Rule" or the "Proposed Rule") would facilitate these arrangements by extending a particular privilege – the right of state-chartered banks and insured branches of foreign banks to preempt state usury laws – to non-bank entities, notwithstanding the fact that these insured banks are afforded this privilege only because they submit to extensive oversight and supervision by the FDIC. As one FDIC board member who voted against the Proposed Rule said, "It is

[1] *See* F.D.I.C., *Federal Interest Rate Authority*, 84 Fed. Reg. 66,845 (proposed Dec. 6, 2019) (to be codified at 12 C.F.R. § 331) (the "Notice of Proposed Rulemaking").

essential that the FDIC not unnecessarily undermine the application of state consumer protection laws to rent-a-charter relationships. This proposed rule could well have that effect."[2]

As explained in detail below, the FDIC has no authority to unilaterally rewrite federal statutory and constitutional law to suit its policy preferences. Unfortunately, that is precisely what the Proposed Rule does.

At a time when Americans of all political backgrounds are demanding that loans with triple-digit interest rates be subject to more, not less, regulation,[3] it is disappointing that the FDIC instead seeks to expand the availability of exploitative loans that trap borrowers in a never-ending cycle of debt. For the reasons discussed herein, we urge the FDIC to withdraw proposed section 331.4(e) in its entirety.

I. Summary of the FDIC's Preemption Proposal

The Proposed Rule is purportedly designed to address "uncertainty" created by the 2015 decision of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*.[4] The Proposed Rule concerns preemption under the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811 *et seq.* ("FDIA"), a federal banking law administered by the FDIC that applies to state-chartered banks and insured branches of foreign banks ("State Banks"). The Proposed Rule would effectively overturn *Madden* and significantly expand FDIA preemption under the pretense of codifying something the FDIC calls "valid-when-made," an archaic "rule" that has nothing to do with preemption and was never mentioned in *Madden*.

As the FDIC acknowledges, the legal issue in *Madden* was preemption under the National Bank Act, 12 U.S.C. §§ 1 *et seq.* ("NBA"), a federal banking law that applies to national banks and federal savings associations and is administered by the Office of the Comptroller of the Currency ("OCC").[5] The preemption provisions in the FDIA closely parallel those in the NBA, and courts interpret them consistently.[6]

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[2] Federal Deposit Insurance Corporation, *Statement by Martin J. Gruenberg, Member, FDIC Board of Directors Notice of Proposed Rulemaking on Federal Interest Rate Authority* (Nov. 19, 2019), *available at* https://www.fdic.gov/news/news/speeches/spnov1919d.html.

[3] For example, when South Dakota voted on an interest rate cap in 2016, the payday loan industry spent over a million dollars lobbying against the measure, which was ultimately approved by 76% of voters in what one opponent of the cap conceded was a "landslide." *See* Bart Pfankuch, *Payday Loans Gone, But Need for Quick Cash Remains*, Capital Journal (Pierre, S.D.), Mar. 23, 2018.

[4] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).

[5] The OCC recently issued a proposed rule closely related to the FDIC's Proposed Rule, but concerning preemption under the NBA. *See* O.C.C., *Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*, 84 Fed. Reg. 64,229 (proposed November 21, 2019) (to be codified at 12 C.F.R. § 7.40001 and 12 C.F.R. § 160.110) (the "OCC Proposed Rule").

[6] Because of the similarities between the FDIA and NBA, many of the arguments made by a coalition of 22 States in a comment letter urging the OCC to withdraw the OCC Proposed Rule apply with equal force to the FDIC's Proposed Rule. *See* Letter from State Attorneys General to Joseph M. Otting, (Jan. 21, 2020), https://www.regulations.gov/document?D=OCC-2019-0027-0046. These arguments are incorporated herein by reference.

Madden concerned a credit card debt originated by a national bank and subsequently sold to an unaffiliated third-party debt collector. The debt collector sent the plaintiff, a New York resident, a collection notice seeking to recover the debt at an interest rate of 27%, which violates New York's usury cap. The plaintiff sued the debt collector, arguing that its attempt to collect interest that is usurious in New York violated federal and state debt collection statutes. The debt collector argued that, even though it itself was not a national bank, the plaintiff's claims were preempted by the NBA, because the debt at issue was originated by a national bank.[7]

Under the NBA and Supreme Court precedent, national banks are permitted to charge the maximum interest rate permissible in the state in which they are located, and to "export" that interest rate to borrowers in other states, even if the rate would violate those states' usury laws.[8] As to such loans originated by national banks, state usury laws are preempted. Section 27 of the FDIA grants State Banks this same privilege to preempt state usury laws when they do business outside of the states in which they are "located."[9] As the Second Circuit in *Madden* explained, national banks are only afforded this privilege under the NBA because they have submitted to comprehensive regulatory oversight by federal banking regulators.[10] The same is true for FDIC-regulated State Banks. The right to export interest rates is conferred upon banks *qua* banks.[11]

In *Madden*, the Second Circuit acknowledged the limited circumstances under which a national bank's ability to export its interest rate could extend to non-bank entities, and set forth the standard to apply in such an inquiry: "To apply NBA preemption to an action taken by a non-national bank entity, application of state law to that action must significantly interfere with a national bank's ability to exercise its power under the NBA."[12] The Second Circuit found that standard unmet because application of usury laws to debts originated by national banks would not prevent banks from selling debts. At most, it could reduce the price national banks could charge for such debts,[13] and would in no way impact sales to other national banks or State Banks. Moreover, the Court held that extending NBA privileges to unaffiliated assignees of national

[7] *See Madden*, 786 F.3d at 249.

[8] *See Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003).

[9] 12 U.S.C. § 1831d(a). The interplay between FDIA provisions regarding interest rates and state usury laws is variously described as interest rate exportation or FDIA preemption, both of which refer to the same legal issues.

[10] *See Madden*, 786 F.3d at 251 (noting that entities other than national banks are "neither protected under federal law nor subject to the OCC's exclusive oversight") (internal citation and quotation marks omitted).

[11] *See, e.g.*, 12 U.S.C. §§ 85, 1831d.

[12] *See Madden*, 786 F.3d at 250 (citing *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996)).

[13] *See id.* at 250-51 ("Here, however, state usury laws would not prevent consumer debt sales by national banks to third parties. Although it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states (i.e., those with firm usury limits, like New York), such an effect would not 'significantly interfere' with the exercise of a national bank power.") (quoting *Barnett Bank*).

banks "would be an overly broad application of the NBA" and would "create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank."[14]

The financial services industry's response to *Madden* was dire. The defendants in *Madden* predicted "catastrophic consequences for secondary markets that are essential to the operations of national banks and the availability of consumer credit,"[15] and a trade group warned that *Madden* "threatens to cause significant harm to [credit] markets, the banking industry, and the millions of families and businesses they serve."[16] Contrary to these predictions, the sky has not fallen in the nearly five years since *Madden* was decided. The OCC testified to Congress in December 2019 that the U.S.'s current economic expansion is "the longest in U.S. history, which has benefited banks' overall financial performance and banks have helped maintain that momentum. *Capital and liquidity remain near historic highs*."[17] The FDIC has similarly stated 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] And *Madden* certainly does not appear to be affecting the profitability of banks' credit card lending

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[14] *See Madden*, 786 F.3d at 251-52.

[15] *See* Petition for Panel Rehearing and Rehearing En Banc by Defendants-Appellees at 1, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015) (14-CV-2131).

[16] *See* Brief of the Clearing House Association LLC as Amici Curia in Support of Rehearing and Rehearing En Banc at 1, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015) (14-CV-2131).

[17] *See Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions: Hearing Before the H. Comm. on Fin. Servs.*, 116 Cong. 3 (2019) (statement of Joseph M. Otting, Comptroller of the Currency) (emphasis added), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-ottingj-20191204.pdf.

[18] *See* FDIC Notice of Proposed Rulemaking, 84 Fed. Reg. at 66,850 (emphasis added). The only evidence that *Madden* has in any way impacted lending in the Second Circuit comes from two academic studies that show a modest decrease in marketplace loans issued in the year after *Madden* was decided. A 2016 study – conducted using proprietary and non-public data from three non-bank lenders – found that *Madden* "led to a decrease in marketplace loans issued above usury caps in New York and Connecticut." *See* Colleen Honigsberg, Robert J. Jackson, Jr., & Richard Squire, *What Happens When Loans Become Legally Void? Evidence from a Natural Experiment*, (Dec. 2, 2016), at 5, *available at* https://www-cdn.law.stanford.edu/wp-content/uploads/2016/12/Honigsberg-et-al-2016-What-Happens-when-Loans-Become-Legally-Void.pdf. A 2018 study – conducted using data from two non-bank lenders – found that "the volume of lending by banks and other non-bank lenders is left unaffected by *Madden*," but that marketplace lending decreased. *See* Piotr Danisewicz and Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy*, (July 5, 2018) at 4, *available at* https://philadelphiafed.org/-/media/bank-resources/supervision-and-regulation/events/2018/fintech/resources/paper%202_piotr_financial_technology_and_bankruptcy.pdf?la=en. As supporters of *responsible* efforts to increase access to credit, these studies suggest one salutary consequence of *Madden* is that lenders may be issuing fewer unaffordable loans to consumers unlikely to be able to repay them. Moreover, we note that the 2018 study repeatedly characterized banks in rent-a-bank arrangements as "fronting" for the non-bank lenders. *See id.* at 3 (stating that *Madden* "cast doubt on the enforceability of marketplace loans as the majority of these loans are originated by a fronting bank and immediately sold to marketplace platforms"), 9, 10, 12. The study's use of this term is apt, as a "front" is a "person or group that serves to conceal the true identity or activity of the person or group in control." Black's Law Dictionary 678 (7th ed. 1999).

which, according to a recent headline in the *Washington Post*, "reported blockbuster 2019 profit with the help of consumers' credit card debt."[19]

The FDIC apparently disagrees with *Madden*, but one would be hard-pressed to understand why from the Notice of Proposed Rulemaking ("NPRM"), which engages the merits of the decision only obliquely. Instead, the NPRM focuses on general contract principles to conclude that FDIA preemption can be assigned. One such "principle" is "valid-when-made," which the FDIC describes as a "rule [that] provides that usury must exist at the inception of the loan for a loan to be deemed usurious; as a corollary, if the loan was not usurious at inception, the loan cannot become usurious at a later time, such as upon assignment, and the assignee may lawfully charge interest at the rate contained in the transferred loan."[20] It is not clear the extent to which the FDIC is relying upon valid-when-made,[21] but the NPRM nowhere addresses the substantial doubts as to the meaning and historical pedigree of valid-when-made.[22]

The Proposed Rule proceeds from the flawed assumption that FDIA preemption is a property interest that can be assigned. It is not. The right to interest rate exportation is a status conferred under federal law upon a State Bank that is personal to the State Bank. As the OCC has previously acknowledged: "Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself."[23] Because this preemptive status is not

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[19] *See* Renae Merle, *Banks Reported Blockbuster 2019 Profit With the Help of Consumers' Credit Card Debt*, Wash. Post, Jan. 15, 2020, *available at* https://www.washingtonpost.com/business/2020/01/15/banks-reported-blockbuster-2019-profit-with-help-consumers-credit-card-debt/. The article notes that interest rates on credit cards are at near record highs despite several interest-rate cuts by the Federal Reserve.

[20] *See* Notice of Proposed Rulemaking at 66,848.

[21] In the NPRM itself, the FDIC states that its interpretation of the preemptive effect of FDIA section 27 "is not based on the common law 'valid when made' rule, although it is consistent with it." *See* Notice of Proposed Rulemaking at 66,848. However, in a press release announcing the Proposed Rule, the FDIC stated that the Proposed Rule "seeks to reaffirm and codify this 'valid-when-made' doctrine." *See* Press Release, FDIC, *FDIC Proposes New Rule Clarifying Federal Interest Rate Authority* (Nov. 19, 2019), *available at* https://www.fdic.gov/news/news/press/2019/pr19107.html.

[22] *See* Brief of Professor Adam J. Levitin as Amicus Curiae in Support of Plaintiff at 26, *Rent-Rite Super Kegs W., Ltd. v. World Business Lenders, LLC* (D. Colo.) (19-CV-01552-REB) ("If the 'valid-when-made' doctrine were a 'cardinal rule' of banking law, founded on Supreme Court opinions, one would expect it to regularly appear in 19th and 20th century usury and banking law treatises. Yet the doctrine is entirely unknown to historical treatise writers. Nothing even approaching the 'valid-when-made' doctrine in which the assignment of a loan from an originator to an assignee subject to a different state usury law appears in any 19th or 20th century usury treatise. No prior reference to 'valid-when-made' can be found in *any* banking or usury treatise."). Indeed, the Second Circuit did not mention "valid-when-made" in *Madden*, perhaps because none of the parties' briefs did. The first federal court opinions to use the terms "valid-when-made doctrine" or "valid-when-made rule" post-date *Madden* by more than two years and arise from just two cases, both in the District of Colorado. *Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134, 1152 (D. Colo. 2018); *In re Rent-Rite Superkegs W., Ltd.*, 603 B.R. 41, 66 (Bankr. D. Colo. 2019).

[23] John D. Hawke, Jr., Comptroller of the Currency, *Remarks Before the Women in Housing and Finance* at 10 (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

conferred *under a contract* – but rather under federal law – valid-when-made or any doctrine concerning the assignability of rights under contract are irrelevant. Nowhere in the NPRM does the FDIC cite any case holding that a personal status conferred by federal law is assignable, or explain how a principle of contract law could override federal law.

Most concerning from the States' perspective, the NPRM does not address the Second Circuit's policy-based concern that extending federal preemption to entities other than federally regulated banks would place them outside the reach of any regulator. Consumer protection has historically been among the police powers exercised by the States, and the vast majority of States – including most of the signatories to this letter – rely on usury caps to prevent consumer harm from the abuses endemic to unaffordable, high-cost loans.[24] And while the FDIC disclaims support of rent-a-bank schemes,[25] the Proposed Rule purports to preempt state law and exempt from state usury limits *any* entity that happens to acquire debt originated by a State Bank. This is the essence of all rent-a-bank schemes.[26]

II. **The FDIC's Proposed Permissible Interest Rule Is Contrary to Law**

The FDIC's Proposed Rule would extend state-law preemption to non-bank debt buyers by declaring that, pursuant to FDIA section 27's grant of preemptive authority to State Banks, "[t]he permissibility … of interest on a loan shall not be affected by any subsequent events, including … the sale, assignment, or other transfer of the loan."[27] This attempt to exempt from state law loan assignees that the FDIC does not insure or regulate conflicts with the statutory scheme Congress enacted in the FDIA and is beyond the agency's authority to grant.

Courts have consistently held the rulemaking authority of federal agencies is constrained by the statutory language Congress chose to enact. "An agency's 'power to promulgate legislative regulations is limited to the authority delegated' to it by Congress."[28] When

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[24] Those states without usury caps have an interest in retaining the ability to impose caps in the future should the need arise.

[25] *See* Notice of Proposed Rulemaking at 66,846 ("The regulations do not address the question of whether a State bank or insured branch of a foreign 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.' Moreover, the FDIC supports 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.").

[26] Indeed, at least three California non-bank lenders have publicly announced their plans to evade that state's interest rate caps through rent-a-bank schemes. *See* Hannah Wiley, *California Made Triple-Digit Interest Illegal on These Loans. Lenders Have Found a Loophole*, The Sacramento Bee, Dec. 18, 2019, *available at* https://www.sacbee.com/news/politics-government/capitol-alert/article238501288.html#storylink=cpy. Following California's passage of stricter lending rules, Elevate Credit, Enova International, and Curo Group Holdings all told investors that they were working to evade the new law through partnerships with out-of-state banks – precisely the behavior the FDIC's Proposed Rule would facilitate. *See id.*

[27] Notice of Proposed Rulemaking at 66,853 (to be codified at 12 C.F.R. § 331.4(e)).

[28] *Amalgamated Transit Union v. Skinner*, 894 F.2d 1362, 1368 (D.C. Cir. 1990) (quoting *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988)).

"Congress has explicitly left a gap for the agency to fill, . . . the agency [may] elucidate a specific provision of the statute by regulation."[29]

By contrast, an agency has no authority to alter the regulatory landscape if "Congress has supplied a clear and unambiguous answer to the interpretive question at hand."[30] "If the intent of Congress is clear, that is the end of the matter; for [any reviewing] court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[31] As the Supreme Court has affirmed, it is a "core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[32]

A. The Proposed Rule Conflicts with the Plain Text of FDIA Section 27(a)

The primary statutory provision the Proposed Permissible Interest Rule purports to interpret – FDIA section 27(a), codified at 12 U.S.C. § 1831d(a) – is clear and unambiguous. Section 27(a) provides

> In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, … such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest … at the rate allowed by the laws of the State, territory, or district where the bank is located[.]

Simply put, when a State Bank makes loans out-of-state and the law of the second state has a lower interest rate cap, the second state's law is preempted and the State Bank may export any rate permissible where it is "located."[33] Section 27(a) grants an explicit and valuable right to State Banks – and no one else.

Section 27(a) says nothing about interest chargeable by assignees, transferees, or purchasers of bank loans. As one court recently explained, "[t]his language governs what charges a 'State bank' may impose, but … does not on its face regulate interest or charges that may be imposed by a non-bank, including one which later acquires or is assigned a loan made or originated by a state bank."[34] The FDIC's Proposed Rule would alter this statutory provision, even though the FDIC nowhere points out any "ambiguity" or "statutory gap" in section 27(a)'s straightforward text.[35]

The FDIC notes that its interpretation rests, in part, on its view that "[s]ection 27 of the FDI Act was enacted to provide State banks with interest rate authority similar to that provided

[29] *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984).

[30] *Pereira v. Sessions*, 138 S. Ct. 2105, 2113 (2018).

[31] *Id.* (quoting *Chevron*, 467 U.S. at 842-43).

[32] *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 328 (2014).

[33] *See* 12 U.S.C. § 1831d.

[34] *Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134, 1144-45 (D. Colo. 2018).

[35] *See Chevron*, 467 U.S. at 843-44.

to national banks under the National Bank Act, 12 U.S.C. 85 [*sic*]."[36] But the link between FDIA section 27 and NBA section 85 only further demonstrates that preemption flows only to banks. Like section 27, NBA section 85 discusses only what interest rates "[a]ny association [*i.e.*, any national bank] may take receive, reserve, and charge … ." Section 85 too makes no mention of interest rates chargeable by non-banks.

Nevertheless, the Proposed Rule would cloak non-banks in section 27(a)'s preemptive power. The proposed regulations would provide, "The permissibility under section 27 of the Federal Deposit Insurance Act of interest on a loan shall not be affected by any subsequent events, including … the sale, assignment, or other transfer of the loan."[37]

The agency's use of passive voice obscures what the Proposed Rule would do – expand section 27's preemptive effect and effectively amend the federal code to read "such State bank or such insured branch of a foreign bank [*or the buyer, assignee, or transferee of any loan made by such State bank*] may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest … at the rate allowed by the laws of the State, territory, or district where the bank is located[.]"[38] But this is beyond the agency's power. The FDIC simply "may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[39]

B. <u>The Proposed Rule Conflicts with Federal Bank Regulators' Longstanding Statutory Interpretations and the Intent of Congress</u>

Congress stated explicitly the purpose of allowing State Banks to charge interest at rates allowed by the states in which they are "located," irrespective of the law where they do business: "to prevent discrimination against State-chartered insured depository institutions[.]"[40] As courts have recognized, the statute "does not, on its face, state any purpose with regard to institutions other than federally insured banks."[41] But the FDIC's proposal entirely ignores Congress's stated objective. Permitting non-bank debt buyers to charge interest in excess of state law does not "prevent discrimination" against State Banks; it extends the privilege of preemption beyond the bounds Congress prescribed.

Until now, federal bank regulators have held that the benefits of statutes preempting state usury caps accrue only to banks and that extending such power to non-banks would raise safety and soundness concerns. As the FDIC's sister-regulator, the Office of the Comptroller of the Currency, explained in 2002,

> The benefit that national banks enjoy by reason of [state-law preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank.

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[36] Notice of Proposed Rulemaking at 66,853.

[37] *See* Notice of Proposed Rulemaking at 66,853 (proposed language for 12 C.F.R. § 331.4 (e)).

[38] 12 U.S.C. §1831d (text in italics supplied).

[39] *Util. Air Regulatory Grp.*, 573 U.S. at 328.

[40] 12 U.S.C. §1831d.

[41] *Meade*, 307 F. Supp. 3d at 1144.

> Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.
>
> We have recently seen several instances in which nonbank lenders who would otherwise have been fully subject to various state regulatory laws have sought to rent out the preemption privileges of a national bank to evade such laws. Indeed, the payday lending industry has expressly promoted such a "national bank strategy" as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempt to clothe itself with the status of an "agent" of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank.
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> Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender.[42]

This same reasoning holds true for State Banks: preemption of state law is not a piece of property State Banks may sell to the highest bidder. Indeed, this is why the FDIC and other federal regulators have repeatedly stressed that they "view[] unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)."[43]

Recent legislative (in)activity confirms the straightforward reading that section 27 applies to banks only. Had Congress meant to exempt non-bank debt buyers from state usury laws, it could have done so. But as recently as 2018, it *declined to do just that*. The Protecting Consumers' Access to Credit Act would have exempted loan assignees from state usury laws to the same extent as the State Banks that originated the loans, using language very similar to that contained in the FDIC's Proposed Permissible Interest Rule.[44] Following the House's passage of

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[42] John D. Hawke, Jr., Comptroller of the Currency, *Remarks Before the Women in Housing and Finance* at 10 (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf. Courts have also rejected arrangements between State Banks and non-banks – like those criticized by the FDIC – because State Banks that do not bear the predominant economic interest in their loans are not the lender of the loans for preemption purposes. *See, e.g., Cmty. State Bank v. Strong*, 651 F.3d 1241, 1259-60 (11th Cir. 2011) (holding that FDIA preemption does not apply to a State Bank "if it is not the true lender of the loan"); *Pennsylvania v. Think Fin., Inc.*, No. 14-CV-7139, 2016 WL 183289, at *13 (E.D. Pa. Jan. 14, 2016) (same).

[43] OCC Bulletin 2018-14, *Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending* (May 23, 2018), *available at* https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html; *accord* FDIC Board Meeting, *Statement by FDIC Chairman Jelena McWilliams on the Notice of Proposed Rulemaking: Federal Interest Rate Authority* (Nov. 19, 2019), *available at* https://www.fdic.gov/news/news/speeches/spnov1919.pdf.

[44] *See* H.R. 3299, 115th Cong. (2017-2018), *available at* https://www.congress.gov/bill/115th-congress/house-bill/3299/text (proposing to amend 12 U.S.C. § 1831d to provide that loans made by insured banks at interest rates in excess of state usury caps applicable to assignees of those loans "shall

the proposed legislation, the Senate took no action, allowing it to expire at the close of the 115th Congress.[45] Congress's consideration and rejection of the policy the FDIC now proposes demonstrate that neither current law nor the will of Congress support the proposal.

C. The Proposed Rule Conflicts with Other Elements of the Statutory Scheme Governing State Banks

In construing the statutes it administers, the FDIC may not cherry pick the provisions it likes and discard the others. An agency's "reasonable statutory interpretation must account for both 'the specific context in which . . . language is used' and 'the broader context of the statute as a whole.'"[46] The FDIC's Proposed Rule fails this test. Language following section 27(a) makes clear that Congress intended the benefits of federal preemption to accrue *only* to State Banks.[47]

Because section 27(a) preempts otherwise applicable state law and allows a State Bank to charge interest at whatever rate is permitted in the state where it is located, in section 27(b) Congress went on provide remedies applicable when a State Bank charges rates *even higher* than those allowed in the state of its location. Section 27(b) provides, "If [a] greater rate of interest [than permitted by section 27(a)] has been paid, the person who paid it may recover … an amount equal to twice the amount of the interest paid *from such State bank or such insured branch of a foreign bank taking*, receiving, reserving, or charging such interest."[48] Notably, section 27(b) contemplates that only banks would benefit from section 27(a)'s preemption and thus potentially be subject to 27(b)'s penalties. Section 27(b)'s omission of any entities other than State Banks further indicates the benefits of preemption under section 27(a) are for State Banks alone.

D. Additional Sources of Authority Cited by the FDIC Lend No Support

The FDIC cites additional sources of law to buttress its Proposed Rule, but none overcome Congress's clear and unambiguous statements limiting the benefits of section 27(a) to State Banks. "Invoking some brooding federal interest or appealing to a judicial policy preference" is not enough to displace state law; rather, one "must point specifically to 'a constitutional text or a federal statute' that does the displacing or conflicts with state law."[49] But the NPRM does little more than gesture toward State Banks' authority to "make loans" and

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remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any State law to the contrary").

[45] *See* S. 1642, 115th Cong. (2017-2018), *available at* https://www.congress.gov/bill/115th-congress/senate-bill/1642/actions?q=%7B%22search%22%3A%5B%22S1642%22%5D%7D&r=2&s=1 (only recorded Senate action on bill is introduction on July 27, 2017).

[46] *Util. Air Regulatory Grp.*, 573 U.S. at 321 (quoting *Robinson v. Shell Oil Co.,* 519 U.S. 337, 341 (1997)).

[47] *See* 12 U.S.C. §§ 1831d(b).

[48] *Id.*

[49] *Va. Uranium, Inc. v. Warren*, 139 S. Ct. 1894, 1901 (2019) (quoting *P.R. Dep't of Consumer Affairs v. ISLA Petroleum Corp.*, 485 U. S. 495, 503 (1988)).

"assign loans."[50] That is not enough to justify extending State Banks' preemption privilege to non-banks.

Because State Banks' powers generally derive from state, not federal, law, the FDIC's search for a federal preemption hook is somewhat tortuous.[51] The NPRM notes that "State banking laws" allow State Banks to "lend money" and "typically grant State [B]anks the power to sell or transfer loans, and more generally, to engage in banking activities … that are 'incidental to banking.'"[52] Even if this broad generalization is accurate, that banks may sell loans and engage in other activities "incidental to banking" does not imply *non-banks* may escape state laws of general applicability.[53] Nevertheless, according to the NPRM,

> Banks' power to make loans implicitly carries with it the power to assign loans, and thus, a State bank's statutory authority under section 27 to make loans at particular rates necessarily includes the power to assign the loans at those rates. Denying an assignee the right to enforce a loan's terms would effectively prohibit assignment and render the power to make the loan at the rate provided by the statute illusory.[54]

But the FDIC's string of suppositions (state law permits banks to make loans → federal law permits banks to charge interest at particular rates → state law permits banks to assign loans → *non-banks* may charge interest in excess of state law) simply does not follow. The power of State Banks to lend and assign debt sheds no light on whether the FDIC may exempt new classes of entities from compliance with state law, and application of state law to debt buyers does not inhibit State Banks' exercise of their section 27 powers. As the Second Circuit explained in *Madden*, "state usury laws would not prevent consumer debt sales by … banks to third parties."[55] At most, they "might decrease the amount a … bank could charge for its consumer debt in certain states[.]"[56] But a mere price decrease hardly renders "illusory" a State Bank's own section 27 authority to charge rates in excess of otherwise applicable state law. Indeed, the NPRM entirely fails to consider that state usury laws have no impact on a State Bank's ability to sell debt to other banks.

Finally, the NPRM cites FDIA sections 9(a) (Tenth) and 10(g), which authorize the FDIC to propose regulations "as necessary to carry out" the other authorities Congress has conferred.[57] But these provisions are not enough to support the Proposed Rule. An agency's rulemaking

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[50] Notice of Proposed Rulemaking at 66,845.

[51] *See id.* at 66,848.

[52] *Id.* at 66,848 & n.31 (citing N.Y Banking Law § 961(1) and claiming "[t]he inherent authority of State banks to assign loans that they make is consistent with State banking laws, which typically grant State banks the power to sell or transfer loans, and more generally, to engage in banking activities similar to those listed in the National Bank Act and activities that are 'incidental to banking.'").

[53] *Id.*

[54] *Id.* (footnote omitted).

[55] *Madden*, 786 F.3d at 251.

[56] *Id*.

[57] 12 U.S.C. §§ 1819(a)(Tenth), 1820(g).

authority extends only as far as the gaps Congress has left it to fill.[58] The FDIC's proposal to grant preemption to non-banks fills no such gap and finds no support in the sources of authority the agency cites.

E. The FDIC's Proposal Conflicts with Principles of Federalism

Finally, even if the Proposed Rule were a plausible interpretation of the statutory scheme, it would fail for lack of sufficient indication that Congress intended to preempt state law with respect to non-banks. The Supreme Court has held that, unless Congress has chosen to "occupy the legislative field," agencies must begin with "the assumption that the historic police powers of the States are not to be superseded by [federal law] unless that was the clear and manifest purpose of Congress."[59] The presumption against preemption "applies with particular force when Congress has legislated in a field traditionally occupied by the States. . . . Thus, when the text of a preemption clause is susceptible of more than one plausible reading, courts ordinarily accept the reading that disfavors preemption."[60]

Field preemption is not at issue here. Despite the federal government's regulatory involvement with insured State-chartered banks, state law still provides the background rules for depository institutions,[61] and Congress has explicitly affirmed that even the law governing *federally* chartered banks "does not occupy the field in any area of State law."[62] There is no question that consumer protection laws, like usury caps, are among those historic police powers held by the States.[63] Accordingly, the strong presumption against preemption applies to the Proposed Permissible Interest Rule. Even if the agency's interpretation of section 27(a) were among several reasonable readings, that interpretation must yield to the reasonable non-preemptive interpretation that banks, and only banks, may charge interest in excess of otherwise applicable state law.[64]

III. The Proposed Rule Violates the Administrative Procedure Act

The Proposed Rule is not only contrary to Congress' statutory scheme set forth in the FDIA, it also violates the Administrative Procedure Act, 5 U.S.C. §§ 550 *et seq.* (the "APA"), in multiple ways. The APA requires "reasoned decision making," wherein the grounds for agency

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[58] *Chevron*, 467 U.S. at 843-44.

[59] *Altria Grp., Inc. v. Good*, 555 U.S. 70, 76-77 (2008) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

[60] *Id.* (internal citations and quotation marks omitted).

[61] *See* Notice of Proposed Rulemaking at 66,848 (describing state law grants of power to State Banks); *cf. Atherton v. F.D.I.C.*, 519 U.S. 213, 225 (1997) (bank management's fiduciary duties are established by state, rather than federal, common law); *see also Thomas v. U.S. Bank Nat'l Ass'n ND*, 575 F.3d 794, 797 (8th Cir. 2009) (holding "[c]omplete preemption" is inapplicable under section 1831d because "Congress very clearly intended the preemptive scope of [that provision] to be limited to particular circumstances").

[62] 12 U.S.C. § 25b(b)(4); *accord* 12 U.S.C. § 1465(b).

[63] *Cf. Altria Grp.,* 555 U.S. at 76–77 (holding that federal tobacco regulations did not preempt state consumer protection law).

[64] *Id.*

action must be "logical and rational."[65] The APA embodies a "basic presumption of judicial review," through which reviewing courts set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[66] The FDIC's attempt to regulate non-bank entities is in excess of its statutory authority, and its proposal to allow non-bank entities to charge interest in excess of state usury laws is arbitrary and capricious, all in violation of the APA.

A. The Lack of Statutory Authority for the Proposed Rule Renders It Unlawful Under the APA

The APA provides that an agency action is unlawful when it is undertaken "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right" or "without observance of procedure required by law."[67] As discussed above, the FDIC lacks the authority to issue the Proposed Rule under any provision of the FDIA. The Proposed Rule thus violates Section 706(2)(C) of the APA.[68]

B. The Proposed Rule Is Arbitrary and Capricious

In addition to being unlawful for lacking statutory authority, the Proposed Rule is arbitrary and capricious because the FDIC (1) relies on factors which Congress has not intended it to consider, (2) fails to consider the rent-a-bank schemes the Proposed Rule would facilitate, and (3) fails to support its proposal with factual findings, and its conclusion actually runs *counter* to the FDIC's own market observations.[69]

1. Congress Did Not Intend for the FDIC to Consider Non-Banks In Any Proposed Rulemaking

The best evidence that Congress did not intend for the FDIC to extend preemption to non-bank entities is that Congress itself weighed this possibility and declined to allow this conduct, reasonably so. As discussed above, in 2018 Congress declined to enact a law that would accomplish legislatively what the FDIC seeks to accomplish administratively. Therefore, Congress has already "directly spoken to the precise question at issue" and rejected attempts to

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[65] *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998).

[66] *Dep't of Commerce v. New York*, 139 S. Ct. 2551, 2567 (2019) (citing 5 U.S.C. § 706(2)(A)).

[67] 5 U.S.C. § 706(2).

[68] *See Haitian Ctrs. Council, Inc. v. Sale*, 823 F. Supp. 1028, 1047-48 (E.D.N.Y. 1993) (holding that Sections 207 and 208 of the Refugee Act of 1980 established exclusive mechanisms for determining the definition of "refugee" and restricted the Attorney General's authority to circumvent this system and that subjecting detained Haitian refugees to "extra-statutory" screening not contemplated in Sections 207 and 208 was beyond the authority granted to the Attorney General and thus violate section 706(2)(C) of the APA); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000) ("Regardless of how serious the problem an administrative agency seeks to address, however, it may not exercise its authority in a manner that is inconsistent with the administrative structure that Congress enacted into law.") (internal citation and quotation marks omitted).

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

extend FDIA preemption to entities other than State Banks.[70] The FDIC's disregard of Congress renders the Proposed Rule arbitrary and capricious.[71]

2. The FDIC Failed to Consider that Its Proposed Rule Would Facilitate Predatory Rent-A-Bank Schemes

In attempting to justify the need for promulgating the Proposed Rule, the FDIC only considers the hypothetical inability of State Banks to assign their loans to third parties if said third parties are subject to state usury laws.[72] The FDIC posits that the U.S. credit markets depend on the expansion of state interest rate preemption to non-banks, but the agency fails to consider that the primary benefit of this proposed regime will inure to non-bank entities that seek to "rent" (or, in this case, "buy") bank status in order to engage in the business of lending in excess of state usury laws.[73] The FDIC has not addressed how the Proposed Rule, if adopted, will serve to incentivize and sanction predatory rent-a-bank schemes. This failure to consider the substantial negative consequences this rule would have on consumer financial protection across the country renders the FDIC's Proposed Rule arbitrary and capricious.

First, the FDIC suggests that "[d]enying an assignee the right to enforce a loan's terms would effectively prohibit assignment and render the power to make the loan at the rate provided by the statute illusory."[74] This proposition is not supported by any consideration of whether loan assignments have been *curtailed*, let alone effectively prohibited, and to what extent. The types of assignments that would, and *should*, be curtailed are the very products that the FDIC ignores; non-bank entities who seek to "rent" bank preemption. The APA requires an agency to consider the consequences of its proposed actions and justify its decision in light of any negative effects. The FDIC's "conclusory statements do not suffice to explain its decision."[75]

Second, the FDIC's failure to consider how the Proposed Rule invites rent-a-bank schemes is arbitrary and capricious in light of the agency's explicit admission that it is *aware* of the problem. The NPRM recognizes that when State Banks partner with non-bank debt buyers, the State Bank may not be the "true lender" of the resulting loan.[76] But the FDIC inexplicably dismisses the issue and states only that "[t]he regulations do not address the question of whether a State bank … is a real party in interest with respect to a loan …, *e.g.*, which entity is the 'true

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[70] *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2124-25 (2016).

[71] *See Grace v. Whitaker*, 344 F. Supp. 3d 96, 126 (D.C. Cir. 2018) (INS new rule concerning "credible fear" determinations was arbitrary and capricious because there was no "legal basis for an effective categorical ban on domestic violence and gang-related claims").

[72] *See* Notice of Proposed Rulemaking at 66,848.

[73] "[A]gency action is lawful only if it rests on a consideration of the relevant factors and must be invalidated if the agency entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs.*, 463 U.S. at 43 (internal citations omitted).

[74] Notice of Proposed Rulemaking at 66,848.

[75] *Encino Motorcars*, 136 S. Ct. at 2127.

[76] *See* Notice of Proposed Rulemaking at 66,846.

lender.'"[77] The FDIC's tacit admission that the Proposed Rule implicates "true lender" issues indicates a materially critical factor that the FDIC must consider.

The FDIC states that it "views 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."[78] However, separately, the FDIC claims the Proposed Rule is necessary to support "marketplace lending" or the "partner bank origination model" in which a bank originates and immediately sells loans to a nonbank partner.[79] The NPRM leaves unanswered how exactly the FDIC defines "marketplace lending" and which partnerships the agency would view favorably or "unfavorably." The FDIC ignores the consumer harm that is all but sure to ensue if rent-a-bank schemes are allowed and encouraged, and proceeds arbitrarily and capriciously from a one-sided and partial perspective.[80]

3. The FDIC Fails to Offer Any Evidence to Support the Dramatic Expansion of Preemption to Non-Bank Entities

Finally, the Proposed Rule is arbitrary and capricious because the FDIC fails to set forth *any* factual findings or any reasoned analysis supporting its decision to extend preemption to *all* non-bank entities that purchase loans from State Banks. Under the APA, the FDIC "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."[81] That requirement is satisfied when the agency's explanation is clear enough that its "path may reasonably be discerned."[82] But where an agency fails to provide a sufficiently minimal level of analysis, its action is arbitrary and capricious and cannot carry the force of law.[83]

The NPRM contains no factual findings to support the FDIC's alleged doomsday scenario facing the banking industry presumably caused by the *Madden* decision. Quite the opposite, the FDIC contradicts itself and admits, "The FDIC 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."[84] The FDIC speculates that a State Bank's ability to assign a loan "would be substantially diminished" if a subsequent purchaser cannot charge the

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[77] *See id.*

[78] *Id.*

[79] *Id*. at 66,850.

[80] *See Ctr. for Biological Diversity v. Nat'l Highway Traffic Safety Admin.*, 538 F.3d 1172, 1198 (9th Cir. 2008) (agency cannot "put a thumb on the scale" by undervaluing key effects and overvaluing others); *Water Quality Ins. Syndicate v. United States*, 225 F. Supp. 3d 41, 69 (D.D.C. 2016) (invalidating agency decision based on "cherry-pick[ed] evidence"); *accord Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (agency must weigh "the advantages and the disadvantages" of its regulatory decisions).

[81] *Motor Vehicle Mfrs.*, 463 U.S. at 43.

[82] *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc*., 419 U.S. 281, 286 (1974).

[83] *See* 5 U.S.C. § 706(2)(A); *Motor Vehicle Mfrs.*, 463 U.S. at 42-43; *Encino Motorcars*, 136 S. Ct. at 2125.

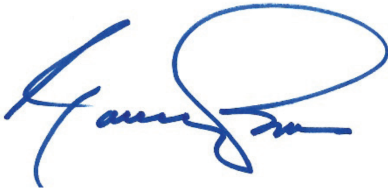
[84] Notice of Proposed Rulemaking at 66,850.

same interest as the bank.[85] The agency further concludes that maintaining permissible interest rates following assignment, regardless of the buyer, is necessary to maintain parity between State Banks and national banks.[86] These assertions are both unsupported and *unsupportable*. The FDIC admits in the NPRM that its hypothetical market consequences have not occurred in *reality* and, as discussed above, the OCC recently testified to Congress that credit markets are functioning smoothly, and national banks are reaping record profits from credit card lending. The FDIC has likewise failed to provide any factual support that parity between State and national banks is *lacking*, or that such absence of parity would in any way be tied to interest charged by *non-banks*. As the Supreme Court has repeatedly affirmed, an agency's failure to include a rational connection between the data and the agency's decision is arbitrary and capricious.[87] Here, the FDIC has presented no data to support its conjecture and speculation, let alone a *connection* between data and its decision.

* * * * *

The FDIC should withdraw the Proposed Rule because the FDIC does not have the authority under the FDIA to preempt state laws on behalf of non-banks; the Proposed Rule violates the APA; and the Proposed Rule is bad policy that will open the floodgates to exploitative and predatory loans that trap consumers in a cycle of debt.

Respectfully submitted,



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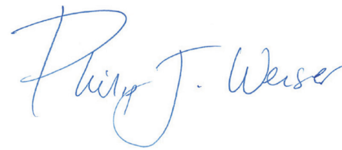

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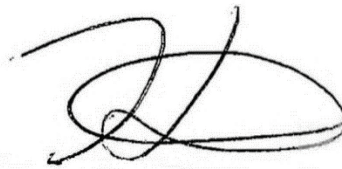

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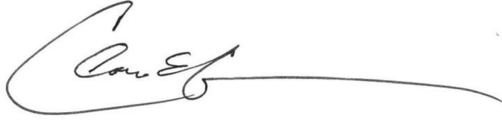
[85] *See* Notice of Proposed Rulemaking at 66,852.

[86] *Id*. at 66,850.

[87] *Dep't of Commerce*, 139 S. Ct. at 2569.



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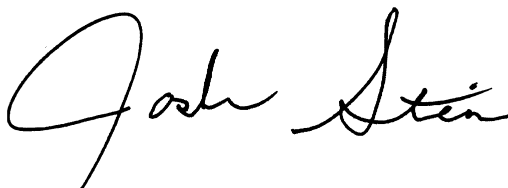

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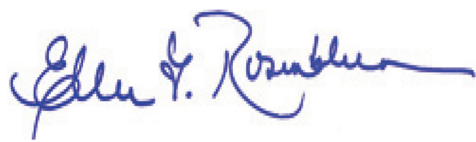

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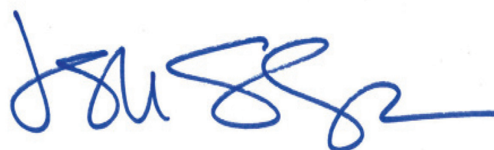

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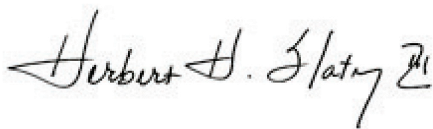

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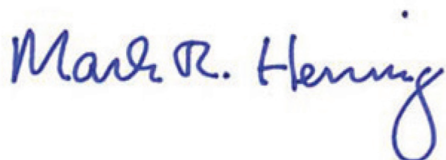

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