

Statement by Martin J. Gruenberg

Member, FDIC Board of Directors

Notice of Proposed Rulemaking on Federal Interest Rate Authority

November 19, 2019

The Notice of Proposed Rulemaking (NPR) before the FDIC Board today is prompted by a 2015 decision of the U.S. Court of Appeals for the Second Circuit, Madden v. Midland Funding, LLC.¹ In that case, the court decided that preemption of state law did not apply to the interest rate terms of a loan agreement following a bank's assignment of a loan to an unrelated nonbank financial company. The Supreme Court denied certiorari in the case.

The NPR would address what it asserts is the uncertainty resulting from the Madden decision and clarify the law that governs the interest rates state-chartered banks may charge.

The proposed regulation would provide that whether an interest rate on a loan is permissible under the Federal Deposit Insurance Act would be determined at the time the loan is made, and the interest rate would not be affected by subsequent events, such as the sale, assignment, or other transfer of the loan.

However, a rule establishing that the interest rate on a loan benefits from state preemption as of the date the loan is made may effectively undermine an evaluation as to whether the bank is the actual or true lender of the loan and not a vehicle for a nonbank third party to benefit from state preemption through a rent-a-charter arrangement.

The preamble to the NPR states that the proposed rule "is not intended to affect the application of State law in determining whether a State bank...is a real party in interest with respect to a loan or has an economic interest in a loan. The FDIC views unfavorably a State bank's partnership with a non-bank entity for the sole purpose of evading a lower interest rate under the law of the entity's licensing state."²

This proposed rule may well be an obstacle to achieving that policy objective. If there is concern about the impact of a court decision on certain types of loans and business models, a careful weighing of the federal and state interests would be required in particular cases, not a blunt rulemaking that may well tip the scales.

¹ 786 F. 3d 246 (2d Cir. 2015).

² Notice of Proposed Rulemaking: Federal Interest Rate Authority preamble at 27.

In addition, the preamble to the NPR asserts that, “Uncertainty 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.”³

Yet the preamble conversely states, “The FDIC is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred at this point as a result of the Madden decision.”⁴

If that is true, it is not quite clear what problem this NPR is seeking to address

Most banks enter into third party arrangements with considerable care and oversee them to ensure consistency with applicable law and bank policy, including appropriate safety and soundness principles and effective consumer compliance programs.

But we have experience with banks that do not take that approach -- that look to make money through rent-a-charter arrangements -- and their partners in these arrangements look to profit from the advantages banks have under federal law. It is 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.

For this reason, I intend to vote against this Notice of Proposed Rulemaking.

³ Preamble at 10.

⁴ Preamble at 28.