Speeches, Statements & Testimonies

Statement by Martin J. Gruenberg Member, FDIC Board of Directors Final Rule on Federal Interest Rate Authority

Last Updated: June 25, 2020

The Final Rule 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 Final Rule 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 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 a change in State law, a change in the relevant commercial paper rate after the loan was made, or the sale, assignment, or other transfer of the loan, in whole or in part.

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 Final Rule states that the 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 established under the law of the entity's licensing State(s)".[2]

As a number of the commenters recognized, this rule may well be an obstacle to achieving that policy objective.[3] In fact, the practical import of today's rulemaking is to further insulate high-cost loans made through these very partnerships between non-banks and bank relationships from legal challenge. It should not go unnoticed that much of the current on-going litigation in this area involves attempts by state authorities to rein in non-banks that have partnered with banks to seek to evade state interest rate laws.[4]

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 against state consumer protection interests in favor of high-cost non-bank lenders.

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 rule could well have that effect.

For this reason, I intend to vote against this Final Rule.

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[1]786 F. 3d 246 (2d Cir. 2015). More recently, a Colorado state court reached a similar conclusion in Fulford v. Marlette Funding, LLC., No. 2017-CV-30376 (Col. Dist. Ct. City and County of Denver, Mar. 3, 2017).

[2]Final Rule: Federal Interest Rate Authority, preamble at 43; *see also* Notice of Proposed Rulemaking: Federal Interest Rate Authority, 84 Fed. Reg. 66845, 66850 (Dec. 6, 2019).

[3]*See,* e.g., Comment letters from Matt Kravitz, the Center for Responsible Lending for 115community, consumer, civil rights, faith and small business organizations at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-049.pdf; 24 State Attorneys General at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-050.pdf; John Ryan for the Conference of State Bank Supervisors at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-033.pdf; Professor Adam J. Levitan, Georgetown Law Center at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-005.pdf; and Prof. Arthur J. Wilmarth, Jr., George Washington University Law School at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-008.pdf.

[4]*See,* e.g., Fulford v. Marlette Funding, LLC., No. 2017-CV-30376 (Col. Dist. Ct. City and County of Denver, Mar. 3, 2017); Meade v. Avant of Colorado, LLC., No. 2017-CV-0620-WJM-STV (D. Colo. Mar. 01, 2018); https://oag.dc.gov/release/ag-racine-sues-predatory-online-lender-illegal. *See also* Comment Letters on NPR from 24 State Attorneys General at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-050.pdf; and John Ryan for the Conference of State Bank Supervisors at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-033.pdf.