

**BILLING CODE 6714-01-P**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**12 CFR Part 331**

**RIN 3064-AF21**

**Federal Interest Rate Authority**

**AGENCY:** Federal Deposit Insurance Corporation.

**ACTION:** Final rule.

**SUMMARY:** The Federal Deposit Insurance Corporation (FDIC) is issuing regulations clarifying the law that governs the interest rates State-chartered banks and insured branches of foreign banks (collectively, State banks) may charge. These regulations provide that State banks are authorized to charge interest at the rate permitted by the State in which the State bank is located, or one percent in excess of the ninety-day commercial paper rate, whichever is greater. The regulations also provide that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined at the time the loan is made, and interest on a loan permissible under section 27 is not affected by a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

**DATES:** The rule is effective on [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** James Watts, Counsel, Legal Division, (202) 898-6678, [jwatts@fdic.gov](mailto:jwatts@fdic.gov); Catherine Topping, Counsel, Legal Division, (202) 898-3975, [ctopping@fdic.gov](mailto:ctopping@fdic.gov).

**SUPPLEMENTARY INFORMATION:**

## **I. Objectives**

Section 27 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831d) authorizes State banks to make loans charging interest at the maximum rate permitted by the State where the bank is located, or at one percent in excess of the ninety-day commercial paper rate, whichever is greater. Section 27 does not state at what point in time the validity of the interest rate should be determined in order to assess whether a State bank is taking or receiving interest in accordance with section 27. Situations may arise when the usury laws of the State where the bank is located change after a loan is made (but before the loan has been paid in full), and a loan's rate may be non-usurious under the old law but usurious under the new law. To fill this statutory gap and carry out the purpose of section 27, the FDIC proposed regulations in November 2019 that would provide that the permissibility of interest under section 27 must be determined when the loan is made, and shall not be affected by a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan. This interpretation protects the parties' expectations and reliance interests at the time when a loan is made, and provides a logical and fair rule that is easy to apply.

A second statutory gap is also present because section 27 expressly gives banks the right to make loans at the rates permitted by their home States, but does not explicitly list all the components of that right. One such implicit component is the right to assign the loans under the preemptive authority of section 27. Banks' power to make loans has been traditionally viewed as carrying with it the power to assign loans. Thus, a State bank's federal statutory authority under section 27 to make loans at particular rates includes the power to assign the loans at those rates. To eliminate ambiguity, the proposed regulation makes this implicit understanding explicit. By providing that the permissibility of interest under section 27 must be determined when the loan is made, and shall not be affected by the sale, assignment, or other transfer of the loan, the

regulation clarifies that banks can transfer enforceable rights in the loans they made under the preemptive authority of section 27.

The FDIC believes that safety and soundness concerns also support clarification of the application of section 27 to State banks' loans, because the statutory ambiguity exposes State banks to increased risk in the event they need to sell their loans to satisfy their liquidity needs in a crisis. Left unaddressed, the two statutory gaps could create legal uncertainty for State banks and confusion for the courts. One example of the concerns with leaving the statutory ambiguity unaddressed is the recent decision of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*.<sup>1</sup> Reading the text of the statute in isolation, the *Madden* court concluded that 12 U.S.C. 85 (section 85) – which authorizes national banks to charge interest at the rate permitted by the law of the State in which the national bank is located – does not allow national banks to transfer enforceable rights in the loans they made under the preemptive authority of section 85. While *Madden* concerned the assignment of a loan by a national bank, the federal statutory provision governing State banks' authority with respect to interest rates is patterned after and interpreted in the same manner as section 85. *Madden* therefore helped highlight the need to issue clarifying regulations addressing the legal ambiguity in section 27.<sup>2</sup>

As described in more detail below, the FDIC received 59 comment letters on the proposed rule from interested parties. The FDIC has carefully considered these comments and is now issuing a final rule. The final rule implements the federal statutory provisions that authorize State banks to charge interest of up to the greater of: one percent more than the 90-day

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<sup>1</sup> 786 F.3d 246 (2d. Cir. 2015).

<sup>2</sup> The Secretary of the Treasury also recommended, in a July 2018 report to the President, that the federal banking regulators should “use their available authorities to address challenges posed by *Madden*.” See “A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation,” July 31, 2018, at p. 93 (available at: <https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf>).

commercial paper rate; or the rate permitted by the State in which the bank is located. The final rule also provides that whether interest on a loan is permissible under section 27 is determined at the time the loan is made, and interest on a loan under section 27 is not affected by a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan. The regulations also implement section 24(j) of the FDI Act (12 U.S.C. 1831a(j)) to provide that the laws of a State in which a State bank is not chartered but in which it maintains a branch (host State), shall apply to any branch in the host State of an out-of-State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank. 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 continues to support 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).

## **II. Background: Current Regulatory Approach and Market Environment**

### **A. National banks’ interest rate authority**

The statutory provisions implemented by the final rule are patterned after, and have been interpreted consistently with, section 85 to provide competitive equality among federally-chartered and State-chartered depository institutions. While the final rule implements the FDI Act, rather than section 85, the following background information is intended to frame the discussion of the rule.

Section 30 of the National Bank Act was enacted in 1864 to protect national banks from discriminatory State usury legislation. The statute provided alternative interest rates that national

banks were permitted to charge their customers pursuant to federal law. Section 30 was later divided and renumbered, with the interest rate provisions becoming current sections 85 and 86.

Under section 85, a national bank may:

take, receive, reserve, and 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, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Revised Statutes.<sup>3</sup>

Soon after the statute was enacted, the Supreme Court's decision in *Tiffany v. National Bank of Missouri* interpreted the statute as providing a "most favored lender" protection.<sup>4</sup> In *Tiffany*, the Supreme Court construed section 85 to allow a national bank to charge interest at a rate exceeding that permitted for State banks if State law permitted nonbank lenders to charge such a rate. By allowing national banks to charge interest at the highest rate permitted for any competing State lender by the laws of the State in which the national bank is located, section 85's language providing national banks "most favored lender" status protects national banks from State laws that could place them at a competitive disadvantage vis-à-vis State lenders.<sup>5</sup>

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<sup>3</sup> 12 U.S.C. 85.

<sup>4</sup> 85 U.S. 409 (1873).

<sup>5</sup> See *Fisher v. First National Bank*, 548 F.2d 255, 259 (8th Cir. 1977); *Northway Lanes v. Hackley Union National Bank & Trust Co.*, 464 F.2d 855, 864 (6th Cir. 1972).

Subsequently, the Supreme Court interpreted section 85 to allow national banks to “export” the interest rates of their home States to borrowers residing in other States. In *Marquette National Bank v. First of Omaha Service Corporation*,<sup>6</sup> the Court held that because the State designated on the national bank’s organizational certificate was traditionally understood to be the State where the bank was “located” for purposes of applying section 85, a national bank cannot be deprived of this location merely because it is extending credit to residents of a foreign State. Since *Marquette* was decided, national banks have been allowed to charge interest rates authorized by the State where the national bank is located on loans to out-of-State borrowers, even though those rates may be prohibited by the State laws where the borrowers reside.<sup>7</sup>

#### **B. Interest rate authority of State banks**

In the late 1970s, monetary policy was geared towards combating inflation and interest rates soared.<sup>8</sup> State-chartered lenders, however, were constrained in the interest they could charge by State usury laws, which often made loans economically unfeasible. National banks did not share this restriction because section 85 permitted them to charge interest at higher rates set by reference to the then-higher federal discount rates.

To promote competitive equality in the nation’s banking system and reaffirm the principle that institutions offering similar products should be subject to similar rules, Congress incorporated language from section 85 into the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA)<sup>9</sup> and granted all federally insured financial

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<sup>6</sup> 439 U.S. 299 (1978).

<sup>7</sup> See *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

<sup>8</sup> See *United State v. Ven-Fuel, Inc.*, 758 F.2d 741, 764 n.20 (1st Cir. 1985) (discussing fluctuations in the prime rate from 1975 to 1983).

<sup>9</sup> Pub. L. 96-221, 94 Stat. 132, 164-168 (1980).

institutions – State banks, savings associations, and credit unions – similar interest rate authority to that provided to national banks.<sup>10</sup> The incorporation was not mere happenstance. Congress made a conscious choice to incorporate section 85’s standard.<sup>11</sup> More specifically, section 521 of DIDMCA added a new section 27 to the FDI Act, which provides:

(a) INTEREST RATES.— 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, if the applicable rate prescribed by this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, 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 a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.<sup>12</sup>

As stated above, section 27(a) of the FDI Act was patterned after section 85.<sup>13</sup> Because section 27 was patterned after section 85 and uses similar language, courts and the FDIC have

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<sup>10</sup> See Statement of Senator Bumpers, 126 Cong. Rec. 6,907 (Mar. 27, 1980).

<sup>11</sup> See *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 827 (1st Cir. 1992); 126 Cong. Rec. 6,907 (1980) (statement of Senator Bumpers); 125 Cong. Rec. 30,655 (1979) (statement of Senator Pryor).

<sup>12</sup> 12 U.S.C. 1831d(a).

<sup>13</sup> Interest charges for savings associations are governed by section 4(g) of the Home Owners’ Loan Act (12 U.S.C. 1463(g)), which is also patterned after section 85. See DIDMCA, Pub. L. No. 96-221.

consistently construed section 27 *in pari materia* with section 85.<sup>14</sup> Section 27 has been construed to permit a State bank to export to out-of-State borrowers the interest rate permitted by the State in which the State bank is located, and to preempt the contrary laws of such borrowers' States.<sup>15</sup>

Pursuant to section 525 of DIDCMA,<sup>16</sup> 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. Iowa and Puerto Rico have opted out of the coverage of section 27 in this manner.<sup>17</sup>

### **C. Interstate branching statutes**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal I) generally established a federal framework for interstate branching for both State banks and national banks.<sup>18</sup> Among other things, Riegle-Neal I addressed the appropriate law to be applied to out-of-State branches of interstate banks. With respect to national banks, the statute amended 12 U.S.C. 36 to provide for the inapplicability of specific host State laws to branches of out-of-State national banks, under specified circumstances, including where Federal law preempted such State laws with respect to a national bank.<sup>19</sup> The statute also provided for preemption

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<sup>14</sup> See, e.g., *Greenwood Trust Co.*, 971 F.2d at 827; FDIC General Counsel's Opinion No. 11, *Interest Charges by Interstate State Banks*, 63 FR 27282 (May 18, 1998).

<sup>15</sup> *Greenwood Trust Co.*, 971 F.2d at 827.

<sup>16</sup> 12 U.S.C. 1831d note.

<sup>17</sup> See 1980 Iowa Acts 1156 § 32; P.R. Laws Ann. tit. 10 § 998I. Colorado, Maine, Massachusetts, North Carolina, Nebraska, and Wisconsin have previously opted out of coverage of section 27, but either rescinded their respective opt-out statutes or allowed them to expire.

<sup>18</sup> Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994).

<sup>19</sup> 12 U.S.C. 36(f)(1)(A), reads, in relevant part:



where the Comptroller of the Currency determines that State law discriminates between an interstate national bank and an interstate State bank.<sup>20</sup> Riegle-Neal I, however, did not include similar provisions to exempt interstate State banks from the application of host State laws. The statute instead provided that the laws of host States applied to branches of interstate State banks in the host State to the same extent such State laws applied to branches of banks chartered by the host State.<sup>21</sup> This left State banks at a competitive disadvantage when compared with national banks, which benefited from preemption of certain State laws.

Congress provided interstate State banks parity with interstate national banks three years later, through the Riegle-Neal Amendments Act of 1997 (Riegle-Neal II).<sup>22</sup> Riegle-Neal II amended the language of section 24(j)(1) to read as it does today:

(j) ACTIVITIES OF BRANCHES OF OUT-OF-STATE BANKS.—

(1) APPLICATION OF HOST STATE LAW.— The laws of a host State, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank. To the extent host State law is inapplicable to a branch of an out-of-State State bank in such host State pursuant to the preceding sentence, home State law shall apply to such branch.<sup>23</sup>

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The laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State, except—

(i) when Federal law preempts the application of such State laws to a national bank.

<sup>20</sup> 12 U.S.C. 36(f)(1)(A)(ii).

<sup>21</sup> Pub. L. 103-328, sec. 102(a).

<sup>22</sup> Pub. L. 105-24, 111 Stat. 238 (July 3, 1997).

<sup>23</sup> 12 U.S.C. 1831a(j)(1).

Under section 24(j), the laws of a host State apply to branches of interstate State banks to the same extent such State laws apply to a branch of an interstate national bank. If laws of the host State are inapplicable to a branch of an interstate national bank, they are equally inapplicable to a branch of an interstate State bank.

#### **D. Agencies' interpretations of the statutes**

Sections 24(j) and 27 of the FDI Act have been interpreted in two published opinions of the FDIC's General Counsel. General Counsel's Opinion No. 10, published in April 1998, clarified that for purposes of section 27, the term "interest" includes those charges that a national bank is authorized to charge under section 85.<sup>24, 25</sup>

The question of where banks are "located" for purposes of sections 27 and 85 has been the subject of interpretation by both the OCC and FDIC. Following the enactment of Riegle-Neal I and Riegle-Neal II, the OCC has concluded that while "the mere presence of a host state branch does not defeat the ability of a national bank to apply its home state rates to loans made to borrowers who reside in that host state, if a branch or branches in a particular host state approves the loan, extends the credit, and disburses the proceeds to a customer, Congress contemplated application of the usury laws of that state regardless of the state of residence of the borrower."<sup>26</sup>

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<sup>24</sup> FDIC General Counsel's Opinion No. 10, *Interest Charged Under Section 27 of the Federal Deposit Insurance Act*, 63 FR 19258 (Apr. 17, 1998).

<sup>25</sup> The primary OCC regulation implementing section 85 is 12 CFR 7.4001. Section 7.4001(a) defines "interest" for purposes of section 85 to include the numerical percentage rate assigned to a loan and also late payment fees, overlimit fees, and other similar charges. Section 7.4001(b) defines the parameters of the "most favored lender" and "exportation" doctrines for national banks. The OCC rule implementing section 4(g) of the Home Owners' Loan Act for both federal and State savings associations, 12 CFR 160.110, adopts the same regulatory definition of "interest" provided by section 7.4001(a).

<sup>26</sup> Interpretive Letter No. 822 at 9 (citing statement of Senator Roth).

Alternatively, where a loan cannot be said to be made in a host State, the OCC concluded that “the law of the home state could always be chosen to apply to the loans.”<sup>27</sup>

FDIC General Counsel’s Opinion No. 11, published in May 1998, was intended to address questions regarding the appropriate State law, for purposes of section 27, that should govern the interest charges on loans made to customers of a State bank that is chartered in one State (its home State) but has a branch or branches in another State (its host State).<sup>28</sup> Consistent with the OCC’s interpretations regarding section 85, the FDIC’s General Counsel concluded that the determination of which State’s interest rate laws apply to a loan made by such a bank depends on the location where three non-ministerial functions involved in making the loan occur – loan approval, disbursement of the loan proceeds, and communication of the decision to lend. If all three non-ministerial functions involved in making the loan are performed by a branch or branches located in the host State, the host State’s interest provisions would apply to the loan; otherwise, the law of the home State would apply. Where the three non-ministerial functions occur in different States or banking offices, host State rates may be applied if the loan has a clear nexus to the host State.

The effect of FDIC General Counsel’s Opinions No. 10 and No. 11 was to promote parity between State banks and national banks with respect to interest charges. Importantly, in the context of interstate banking, the opinions confirm that section 27 of the FDI Act permits State banks to export interest charges allowed by the State where the bank is located to out-of-State borrowers, even if the bank maintains a branch in the State where the borrower resides.

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<sup>27</sup> Interpretive Letter No. 822 at 10.

<sup>28</sup> FDIC General Counsel’s Opinion No. 11, *Interest Charges by Interstate State Banks*, 63 FR 27282 (May 18, 1998).

### **E. Statutory Gaps in Section 27**

Section 27 does not state at what point in time the validity and enforceability under section 27 of the interest-rate term of a bank's loan should be determined. Situations may arise when the usury laws of the State where the bank is located change after a loan is made (but before the loan has been paid in full), and a loan's rate may be non-usurious under the old law but usurious under the new law. Similar issues arise where a loan is made in reliance on the federal commercial paper rate, and that rate changes before the loan is paid in full. To fill this statutory gap and carry out the purpose of section 27,<sup>29</sup> the FDIC concludes that the validity and enforceability under section 27 of the interest-rate term of a loan must be determined when the loan is made, not when a particular interest payment is "taken" or "received." This interpretation protects the parties' expectations and reliance interests at the time when a loan is made, and provides a logical and fair rule that is easy to apply.

A second statutory gap is also present because section 27 expressly gives State banks the right to make loans at the rates permitted by their home States, but does not explicitly list all the components of that right. One such implicit component is the right to assign the loans made under the preemptive authority of section 27. State banks' power to make loans has been traditionally viewed as implicitly carrying with it the power to assign loans.<sup>30</sup> 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 State banks the ability to transfer

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<sup>29</sup> In 12 U.S.C. 1819(a), Congress gave the FDIC statutory authority to prescribe "such rules and regulations as it may deem necessary to carry out the provisions of this chapter," namely Chapter 16 of Title 12 of the U.S. Code. Section 27, codified at Section 1831d of Chapter 16, is a provision of "this chapter."

<sup>30</sup> In *Planters' Bank v. Sharp*, 47 U.S. 301, 323 (1848), a case dealing with the powers of a State bank, the Supreme Court held that a statute that explicitly gave banks the power to make loans also implicitly gave them the power to assign the loans because "in discounting notes and managing its property in legitimate banking business ... [a bank] must be able to assign or sell those notes when necessary and proper."

enforceable rights in the loans they make under the preemptive authority of section 27 would undermine the purpose of section 27 and deprive State banks of an important and indispensable component of their federal statutory power to make loans at the rates permitted by their home State. State banks' ability to transfer enforceable rights in the loans they validly made under the preemptive authority of section 27 is also central to the stability and liquidity of the domestic loan markets. A lack of enforceable rights in the transferred loans' interest rate terms would also result in distressed market values for many loans, frustrating the purpose of the FDI Act, which would also affect the FDIC as a secondary market loan seller. One way the FDIC fulfills its mission to maintain stability and public confidence in the nation's financial system is by carrying out all of the tasks triggered by the closure of an FDIC-insured institution. This includes attempting to find a purchaser for the institution and the liquidation of the assets held by the failed bank. Following a bank closing, the FDIC as conservator or receiver (FDIC-R) is often left with large portfolios of loans.

The FDIC-R has a statutory obligation to maximize the net present value return from the sale or disposition of such assets and minimize the amount of any loss, both in order to protect the Deposit Insurance Fund (DIF).<sup>31</sup> The DIF would be significantly impacted in a large bank failure scenario if the FDIC-R were forced to sell loans at a large discount to account for impairment in the value of those loans in a distressed secondary market. This uncertainty would also likely reduce overall liquidity in loan markets, further limiting the ability of the FDIC-R to sell loans. The *Madden* decision, as it stands, could potentially significantly impact the FDIC's statutory obligation to resolve failed banks using the least costly resolution option and minimizing losses to the DIF.

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<sup>31</sup> 12 U.S.C. 1821(d)

To eliminate ambiguity and carry out the purpose of section 27, the proposed regulation makes explicit that the right to assign loans is a component of banks' federal statutory right to make loans at the rates permitted by section 27. The regulation accomplishes this by providing that the validity and enforceability of the interest rate term of a loan under section 27 is determined at the inception of the loan, and subsequent events such as an assignment do not affect the validity or enforceability of the loan.

The FDIC's proposal, addressing the two statutory gaps in section 27 in a manner that carries out the goals of the federal statute, is based on federal law. Specifically, the rule is based on the meaning of the text of the statute, interpreted in light of the statute's purpose and the FDIC's regulatory experience. It is, however, also consistent with state banking powers and common law doctrines such as the "valid when made" and "stand-in-the-shoes" rules. The "valid when made" rule 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.<sup>32</sup> The banks' ability to transfer enforceable rights in the loans they make is also consistent with fundamental principles of contract law. It is well settled that an assignee succeeds to all the assignor's rights in a contract, standing in the

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<sup>32</sup> See *Nichols v. Fearson*, 32 U.S. (7. Pet.) 103, 109 (1833) ("a contract, which in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction"); see also *Gaither v. Farmers & Merchants Bank of Georgetown*, 26 U.S. 37, 43 (1828) ("[T]he rule cannot be doubted, that if the note free from usury, in its origin, no subsequent usurious transactions respecting it, can affect it with the taint of usury."); *FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir 1981) (bank, as the assignee of the original lender, could enforce a note that was not usurious when made by the original lender even if the bank itself was not permitted to make loans at those interest rates); *FDIC v. Tito Castro Constr. Co.*, 548 F. Supp. 1224, 1226 (D. P.R. 1982) ("One of the cardinal rules in the doctrine of usury is that a contract which in its inception is unaffected by usury cannot be invalidated as usurious by subsequent events.").

shoes of the assignor.<sup>33</sup> This includes the right to receive the consideration agreed upon in the contract, which for a loan includes the interest agreed upon by the parties.<sup>34</sup> Under this “stand-in-the-shoes” rule, the non-usurious character of a loan would not change when the loan changes hands, because the assignee is merely enforcing the rights of the assignor and stands in the assignor’s shoes. A loan that was not usurious under section 27 when made would thus not become usurious upon assignment.

The FDIC’s interpretation of section 27 is also 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.”<sup>35</sup> Similarly, the National Bank Act authorizes national banks to sell or transfer loan contracts by allowing them to “negotiate[]” (*i.e.*, transfer) “promissory notes, drafts, bills of exchange, and other evidences of debt.”<sup>36</sup>

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<sup>33</sup> See *Dean Witter Reynolds Inc. v. Variable Annuity Life Ins. Co.*, 373 F.3d 1100, 1110 (10th Cir. 2004); see also *Tivoli Ventures, Inc. v. Bumann*, 870 P.2d 1244, 1248 (Colo. 1994) (“As a general principle of contract law, an assignee stands in the shoes of the assignor.”); *Gould v. Jackson*, 42 N.W.2d 489, 490 (Wis. 1950) (assignee “stands exactly in the shoes of [the] assignor,” and “succeeds to all of his rights and privileges”).

<sup>34</sup> See *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285, 286-88 (7th Cir. 2005) (assignee of a debt is free to charge the same interest rate that the assignor charged the debtor, even if, unlike the assignor, the assignee does not have a license that expressly permits the charging of a higher rate). As the *Olvera* court noted, “the common law puts the assignee in the assignor’s shoes, whatever the shoe size.” 431 F.3d at 289.

<sup>35</sup> See, e.g., N.Y Banking Law § 961(1) (granting New York-chartered banks the power to “discount, purchase and negotiate promissory notes, drafts, bills of exchange, other evidences of debt, and obligations in writing to pay in installments or otherwise all or part of the price of personal property or that of the performance of services; purchase accounts receivable...; lend money on real or personal security; borrow money and secure such borrowings by pledging assets; buy and sell exchange, coin and bullion; and receive deposits of moneys, securities or other personal property upon such terms as the bank or trust company shall prescribe;. . .; and exercise all such incidental powers as shall be necessary to carry on the business of banking”). States’ “wild card” or parity statutes typically grant State banks competitive equality with national banks under applicable federal statutory or regulatory authority. Such authority is provided either: (1) through state legislation or regulation; or (2) by authorization of the state banking supervisor.

<sup>36</sup> 12 U.S.C. 24(Seventh); see also 12 CFR 7.4008 (“A national bank may make, sell, purchase, participate in, or otherwise deal in loans . . . subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any other applicable Federal law.”). The OCC has interpreted national banks’ authority to sell loans under 12 U.S.C. 24 to reinforce the understanding that national banks’ power to charge interest at the rate provided by section 85 includes the authority to convey the ability to continue to charge interest at that rate. As the OCC has

## F. Proposed Rule

On November 19, 2019, the FDIC published a notice of proposed rulemaking (NPR) to issue regulations implementing sections 24(j) and 27. Through the proposed regulations, the FDIC sought to clarify the application of section 27 and reaffirm State banks' ability to assign enforceable rights in the loans they made under the preemptive authority of Section 27. The proposed regulations also were intended to maintain parity between national banks and State banks with respect to interest rate authority. The OCC has taken the position that national banks' authority to charge interest at the rate established by section 85 includes the authority to assign the loan to another party at the contractual interest rate.<sup>37</sup> Finally, the proposed regulations also would implement section 24(j) (12 U.S.C. 1831a(j)) to provide that the laws of a State in which a State bank is not chartered in but in which it maintains a branch (host State), shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank.

The comment period for the NPR ended on February 4, 2020. The FDIC received a total of 59 comment letters from a variety of individuals and entities, including trade associations, insured depository institutions, consumer and public interest groups, state banking regulators and state officials, a city treasurer, non-bank lenders, law firms, members of Congress, academics, and think tanks. In developing the final rule, the FDIC carefully considered all of the comments that it received in response to the NPR.

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explained, application of State usury law in such circumstances would be preempted under the standard set forth in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996). See Brief for United States as amicus curiae, *Midland Funding, LLC v. Madden* (No. 15-610), at 11.

<sup>37</sup> See 85 FR 33530, 33531 (June 2, 2020).



### **III. Discussion of Comments**

In general, the comments submitted by financial services trade associations, depository institutions, and non-bank lenders expressed support for the proposed rule. These commenters stated that the proposed rule would: address legal uncertainty created by the *Madden* decision; reaffirm longstanding views regarding the enforceability of interest rate terms on loans that are sold, transferred, or otherwise assigned; and reaffirm state banks' ability to engage in activities such as securitizations, loan sales, and sales of participation interests in loans, that are crucial to the safety and soundness of these banks' operations. By reaffirming state banks' ability to sell loans, these commenters argued, the proposed rule would ensure that banks have the capacity to continue lending to their customers, including small businesses, a function that is critical to support the nation's economy. In addition, these commenters asserted that the proposed rule would promote the availability of credit for higher-risk borrowers.

Comments submitted by consumer advocates were generally critical of the proposed rule. These comments stated that the proposed rule would allow predatory non-bank lenders to evade State law interest rate caps through partnerships with State banks, and the FDIC lacks the authority to regulate the interest rates charged by non-bank lenders. Commenters further asserted that regulation of interest rate limits has historically been a State function, and the FDIC seeks to change that by claiming that non-banks that buy loans from banks should be able to charge interest rates exceeding those provided by State law. These commenters also argued that the proposed rule was unnecessary, asserting that there is no shortage of credit available to consumers and no evidence demonstrating that loan sales are necessary to support banks' liquidity.

In addition to these general themes, commenters raised a number of specific concerns with respect to the FDIC's proposed rule. These issues are discussed in further detail below.

## A. Statutory Authority for the Proposed Rule

Some commenters asserted that the proposed rule exceeds the FDIC's authority under section 27 by regulating non-banks or establishing permissible interest rates for non-banks. The FDIC would not regulate non-banks through the proposed rule; rather, the proposed rule would clarify the application of section 27 to State banks' loans. The proposed rule provides that the permissibility of interest on a loan under section 27 would be determined as of the date the loan was made. As the FDIC explained in the NPR, this interpretation of section 27 is necessary to establish a workable rule to determine the timing of compliance with the statute.<sup>38</sup> This rule would apply to loans made by State banks, regardless of whether such loans are subsequently assigned to another bank or to a non-bank. To the extent a non-bank that obtained a State bank's loan would be permitted to charge the contractual interest rate, that is because 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. The regulation would not become a regulation of assignees simply because it would have an indirect effect on assignees.<sup>39</sup>

Some commenters argued that the FDIC lacks authority to prescribe the effect of the assignment of a State bank loan made under the preemptive authority of section 27 because the statutory provision does not expressly refer to the "assignment" of a State bank's loan. The statute's silence, however, reinforces the FDIC's authority to issue interpreting regulations to clarify an aspect of the statute that Congress left open. Agencies are permitted to issue

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<sup>38</sup> See 84 FR 66848.

<sup>39</sup> See *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 776 (2016) (where federal statute limited agency jurisdiction to the wholesale market and reserved regulatory authority over retail sales to the States, a regulation directed at wholesale transactions was not outside the agency's authority and did not overstep on the States' authority, even if the regulation had substantial indirect effects on retail transactions).

regulations filling statutory gaps and routinely do so.<sup>40</sup> The FDIC used its banking expertise to fill the gaps in section 27, and its interpretation is grounded in the terms and purpose of the statute, read within their proper historical and legal context. The power to assign loans has been traditionally understood as a component of the power to make loans. Thus, the power to make loans at the interest rate permitted by section 27 implicitly includes the power to assign loans at those interest rates. For example, the Supreme Court held that a state banking charter statute providing the power to make loans (as section 27 does here) also confers the power to assign them, even if the power to assign is not explicitly granted in the statute.<sup>41</sup> The California Supreme Court reached a similar conclusion.<sup>42</sup> Viewing the power to assign as an indispensable component of the power to make loans under section 27 would also carry out the purpose of the statute. The power to assign is indispensable in modern commercial transactions, and even more so in banking: State banks need the ability to sell loans in order to properly maintain their capital and liquidity. As the Supreme Court explained, “in managing its property in legitimate banking business, [a bank] must be able to assign or sell those notes when necessary and proper, as, for instance, to procure more [liquidity] in an emergency, or return an unusual amount of deposits withdrawn, or pay large debts.”<sup>43</sup> Absent the power to assign loans made under section 27, reliance on the statute could ultimately hurt State banks (instead of benefiting them) should they later face a liquidity crisis or other financial stresses. The FDIC’s interpretation of the statute helps to prevent such unintended results.

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<sup>40</sup> See *Chevron v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984) (agencies have authority to make rules to “fill any [statutory] gap left, implicitly or explicitly, by Congress”).

<sup>41</sup> *Planters’ Bank of Miss. v. Sharp*, 47 U.S. 301, 322-23 (1848) (“in [making] notes and managing its property in legitimate banking business, [a bank] must be able to assign or sell those notes.”).

<sup>42</sup> *Strike v. Trans-West Discount Corp.*, 92 Cal. App. 3d 735, 745 (Cal. Ct. App. 4th Dist. 1979).

<sup>43</sup> *Planters*, 47 U.S. at 323.

Commenters argued that the proposed rule is premised upon the assumption that the preemption of State law interest rate limits under section 27 is an assignable property interest. The proposed rule does not purport to allow State banks to assign the ability to preempt State law interest rate limits under section 27. Instead, the proposed rule would allow State banks to assign loans at their contractual interest rates. This is not the same as assigning the authority to preempt State law interest rate limits. For example, the proposed rule would not authorize an assignee to renegotiate the interest rate of a loan to an amount exceeding the contractual rate, even though the assigning bank may have been able to charge interest at such a rate. Consistent with section 27, the proposed rule would allow State banks to assign loans at the same interest rates at which they are permitted to make loans. This effectuates State banks' federal statutory interest rate authority, and does not represent an extension of that authority.

Commenters stated that Congress has expressly addressed the assignment of loans in other statutory provisions that preempt State usury laws, but did not do so in section 27, suggesting that section 27 was not intended to apply following the assignment of a State bank's loan. In particular, these commenters point to section 501 of DIDMCA,<sup>44</sup> which preempts State law interest rate limits with respect to certain mortgage loans. But careful consideration of section 501 and its legislative history appears to reinforce the view that banks can transfer enforceable rights in the loans they make under section 27. Section 501 does not expressly state that it applies after a loan's assignment.<sup>45</sup> Nevertheless, it is implicit in the section 501's text

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<sup>44</sup> 12 U.S.C. 1735f-7a.

<sup>45</sup> One comment letter suggested that the statute's reference to "credit sales" means that the statute applies to sales of mortgage loans, not just to the originations of such loans. But the statute merely states that it applies to (and exempts from State usury laws) "any loan, mortgage, credit sale, or advance" that is "secured by" first-lien residential mortgages. 12 U.S.C. § 1735f-7a. The statute does not state that it applies to credit sales "of" first-lien residential mortgages. The statute is silent on what happens—upon assignment or sale—to loans, credits sales, or advances that are originated pursuant to the statute.

and structure that a loan exempted from State usury laws when it is made continues to be exempt from those laws upon assignment.<sup>46</sup> Like section 501, section 27 is silent regarding the effect of the assignment or transfer of a loan, and should similarly be interpreted to apply following the assignment or transfer of a loan.

Some commenters also argue that the FDIC lacked the authority to issue the proposed rule because they view State banks' power to assign loans as derived from State banking powers laws. The FDIC's authority to issue the rule, however, is not based on State law. Rather, it is based on section 27, which implicitly authorizes State banks to assign the loans they make at the interest rate specified by the statute. Nor is the FDIC's interpretation based on federal common law or the valid-when-made rule, as some comments argued. In the NPR, the FDIC stated that while the FDIC's interpretation of the statute was "consistent" with the valid-when-made rule, it was not based on it.<sup>47</sup> The proposed rule's consistency with common law principles reinforces parties' established expectations, but as stated in the NPR, the FDIC's authority to issue the proposed rule arises under section 27 rather than common law.

One comment letter argued that the FDIC's proposed rule fails for lack of an explicit reference to assignment in the text of section 27, stating that a presumption against preemption applies to the proposed rule. In a case involving the OCC's interpretation of section 85, however, the Supreme Court noted that a similar argument invoking a presumption against preemption "confuses the question of the substantive (as opposed to pre-emptive) *meaning* of a

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<sup>46</sup> The description of section 501 in the Committee Report appears to confirm this view: "In connection with the provisions in this section, it is the Committee's intent that loans originated under this usury exemption will not be subject to claims of usury even if they are later sold to an investor who is not exempt under this section." Sen. Rpt. 96-368 at 19.

<sup>47</sup> 84 FR 66848 (Dec. 6, 2019).

statute with the question of *whether* a statute is pre-emptive.”<sup>48</sup> The Court held that the presumption did not apply to OCC regulations filling statutory gaps in section 85 because those regulations addressed the substantive meaning of the statute, not “the question of whether a statute is pre-emptive.”<sup>49</sup> The Court reaffirmed that under its prior holdings, “there is no doubt that § 85 pre-empts state law.”<sup>50</sup> Like section 85, section 27 also expressly pre-empts State laws that impose an interest rate limit lower than the interest rate permitted by section 27. Just as in *Smiley*, the question is what section 27 means, and thus, just as in *Smiley*, the presumption against preemption is inapplicable.

One commenter argued that the FDIC is bound by *Madden*’s interpretation of section 85 under the Supreme Court’s *Brand X* jurisprudence. The FDIC disagrees that the *Madden* decision interpreted section 85. Nevertheless, even if *Madden* did interpret section 85, the Supreme Court expressly stated that its *Brand X* decision does not “preclude[] agencies from revising unwise judicial constructions of ambiguous statutes.”<sup>51</sup> Because the statute here is ambiguous, *Brand X* does not preclude the FDIC from filling the two statutory gaps addressed by the proposed regulation. In any event, *Madden*’s interpretation is binding—at most—only in the Second Circuit, and does not preclude the FDIC from adopting a different interpretation.

## **B. Evidentiary Basis for the Proposal**

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<sup>48</sup> *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. at 744 (emphasis in original).

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Brand X*, 545 U.S. at 983. Nothing in *Madden* holds that the statute unambiguously forecloses the agency’s interpretation.

Some commenters asserted that proposed rule violates the Administrative Procedure Act<sup>52</sup> because the FDIC did not provide evidence that State banks were unable to sell loans, or that the market for State banks' loans was distressed. The Administrative Procedure Act does not require an agency to produce empirical evidence in rulemaking; rather, it must justify a rule with a reasoned explanation.<sup>53</sup> Moreover, agencies may adopt prophylactic rules to prevent potential problems before they arise.<sup>54</sup> The FDIC believes that safety and soundness concerns warrant clarification of the application of section 27 to State banks' loans, even if particular State banks or the loan market more generally are not currently experiencing distress. Market conditions can change quickly and without warning, potentially exposing State banks to increased risk in the event they need to sell their loans. The proposed rule would proactively promote State banks' safety and soundness, and it is well-established that empirical evidence is unnecessary where, as here, the "agency's decision is primarily predictive."<sup>55</sup> Nevertheless, the FDIC believes that there is considerable evidence of uncertainty following the *Madden* decision. Commenters pointed to studies discussing the effects of *Madden* in the Second Circuit, as well as anecdotal evidence of increased difficulty selling loans made to borrowers in the Second Circuit post-*Madden*.

One commenter asserted that the proposal failed to include evidence showing that State banks rely on loan sales for liquidity, and stated that the 5,200 banks in the United States provide

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<sup>52</sup> 5 U.S.C. 551 *et seq.*

<sup>53</sup> *Stillwell v. Office of Thrift Supervision*, 569 F.3d 514, 519 (D.C. Cir. 2009). Although some statutes directed at other agencies require that rulemakings by those agencies be based on substantial evidence in the record, Section 27 imposes no such requirement, and neither does the APA. "The APA imposes no general obligation on agencies to produce empirical evidence. Rather, an agency has to justify its rule with a reasoned explanation." *Id.*

<sup>54</sup> *Id.* (noting that "[a]n agency need not suffer the flood before building the levee.").

<sup>55</sup> *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1105 (D.C. Cir. 2009).

a robust market for State banks' loans. Securitizations, which the FDIC mentioned in the proposal, are an example of banks' reliance on the loan sale market to non-banks for liquidity.<sup>56</sup> The comment's focus on whether banks obtain liquidity by selling loans to non-banks also is mistaken. The regulation is not directed at ensuring that State banks can assign their loans to non-banks; rather, it is directed at protecting these banks' right to assign their loans to any assignees, whether banks or non-banks. Moreover, under the commenter's interpretation of section 27, not all 5,200 banks in the United States would be able to enforce the interest terms of an assigned loan. Only banks located in States that would permit the loan's contractual interest rate would be able to enforce the interest rate term of the loan. In addition, reliance on sales to banks alone would not address the FDIC's safety and soundness concerns, because banks may be unable to purchase loans sold by other banks in circumstances where there are widespread liquidity crises in the banking sector.<sup>57</sup>

The FDIC stated in the preamble to the proposed rule that it was unaware of "widespread or significant effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision," and some commenters misunderstood this statement as contradicting the basis for the proposed rule. This statement was included in the discussion of the proposal's potential effects, which the FDIC suggested might fall into two categories: (1) immediate effects on loans in the Second Circuit that may have been directly affected by *Madden*; and (2) the mitigation of the possibility that State banks located in other States might be

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<sup>56</sup> Indeed, the comment concedes that securitizations are a source of liquidity for banks, but argues that only the largest banks engage in securitizations of non-mortgage loans. But this actually appears to highlight the need for the regulation.

<sup>57</sup> The comment asserts that banks' primary sources of liquidity are deposits and wholesale funding markets, Federal Home Loan Bank advances, and the government-sponsored enterprises' cash windows, with the Federal Reserve's discount window as a backup. In the FDIC's experience, some of these sources of liquidity may be unavailable in a financial stress scenario. For example, if a bank is in troubled condition, there are significant restrictions on its ability to use the Federal Reserve's discount window to borrow funds to meet liquidity needs.



impaired in their ability to sell loans in the future. While the available evidence suggested that *Madden*'s effects on loan sales and availability of credit were generally limited to the Second Circuit states in which the decision applied, the FDIC still believes there would be benefits to addressing the legal ambiguity in section 27 before these effects become more widespread and pronounced.

Another commenter asserted that the FDIC's proposal left unanswered questions about the effects *Madden* has had on securitization markets, and whether those effects justify the exemption of securitization vehicles and assigned loans from State usury laws. This exaggerates the effect of the proposal, which would not completely exempt loans from compliance with State usury laws. Rather, the proposed rule would clarify which State's usury laws would apply to a loan, and provide that whether interest on a loan is permissible under section 27 is determined as of the date the loan was made. While the proposal did not include evidence regarding the extent of *Madden*'s effects on securitizations, commenters noted that State banks rely on the assignment of loans through secondary market securitizations to manage concentrations of credit and access other funding sources. Some commenters stated that *Madden* disrupted secondary markets for loans originated by banks and for interests in loan securitizations, and others provided anecdotal evidence that financial institutions involved in securitization markets have been unwilling to underwrite securitizations that include loans with rates above usury limits in States within the Second Circuit.

Some commenters asserted that the proposal ignores a key aspect of the problem, in that it does not address the question of when a State bank is the true lender with respect to a loan. The commenters argue, in effect, that the question of whether a State bank is the true lender is intertwined with the question addressed by the rule – that is, the effect of the assignment or sale of a loan made by a State bank. While both questions ultimately affect the interest rate that may

be charged to the borrower, the FDIC believes that they are not so intertwined that they must be addressed simultaneously by rulemaking.<sup>58</sup> In many cases, there is no dispute that a loan was made by a bank. For example, there may not even be a non-bank involved in making the loan.<sup>59</sup> The proposed rule would provide important clarification on the application of section 27 in such cases, reaffirming the enforceability of interest rate terms of State banks' loans following the sale, transfer, or assignment of the loan.

### **C. Consumer Protection**

Several commenters asserted that the regulation of interest rate limits has historically been a State function, and the proposed rule would change that by allowing non-banks that buy loans from State banks to charge rates exceeding State law limits. The framework that governs the interest rates charged by State banks includes both State and federal laws. As noted above, section 27 generally authorizes State banks to charge interest at the rate permitted by the law of the State in which the bank is located, even if that rate exceeds the rate permitted by the law of the borrower's State. Congress also recognized States' interest in regulating interest rates within their jurisdictions, giving States the authority to opt out of the coverage of section 27 with respect to loans made in the State. Through the proposed rule, the FDIC would clarify the application of this statutory framework. It also would reaffirm the enforceability of interest rate terms following the sale, transfer, or assignment of a loan.

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<sup>58</sup> Agencies have discretion in how to handle related, yet discrete, issues in terms of priorities and need not solve every problem before them in the same proceeding. *Taylor v. Federal Aviation Administration*, 895 F.3d 56, 68 (D.C. Cir. 2018).

<sup>59</sup> *Madden* itself was such a case, as the national bank did not write off the loan in question and sell it to a non-bank debt collector until three years after the consumer opened the account. *See* 786 F.3d at 247-48.

Several commenters asserted that the proposal would facilitate predatory lending. This concern, however, appears to arise from perceived abuses of longstanding statutory authority rather than the proposed rule. Federal court precedents have for decades allowed banks to charge interest at the rate permitted by the law of the bank’s home State, even if that rate exceeds the rate permitted by the law of the borrower’s State.<sup>60</sup> Under longstanding views regarding the enforceability of interest rate terms on loans that a State bank has sold, transferred, or assigned, non-banks also have been permitted to charge the contract rate when they obtain a loan made by a bank. The rule would reinforce the status quo, which was arguably unsettled by *Madden*, with respect to these authorities, but it is not the basis for them.<sup>61</sup> In addition, if States have concerns that nonbank lenders are using partnerships with out-of-State banks to circumvent State law interest rate limits, States are expressly authorized to opt out of section 27.

Commenters also stated that the proposal would encourage so-called “rent-a-bank” arrangements involving non-banks that should be subject to state laws and regulations. The proposed rule would not exempt State banks or non-banks from State laws and regulations. It would only clarify the application of section 27 with respect to the interest rates permitted for State banks’ loans. Importantly, the proposed rule would not address or affect the broader licensing or regulatory requirements that apply to banks and non-banks under applicable State law. States also may opt out of the coverage of section 27 if they choose.

Several commenters focused on “true lender” theories under which it may be established that a non-bank lender, rather than a bank, is the true lender with respect to a loan, with the effect

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<sup>60</sup> *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 827 (1st Cir. 1992).

<sup>61</sup> Some commenters described State banks and non-banks that they believe have engaged in predatory lending. Because the proposed rule has yet to take effect, this reinforces the conclusion that such lending is based on existing statutory authority, rather than the proposed rule.

that section 27 would not govern the loan's interest rate. These commenters asserted that the proposed rule would burden State regulators and private citizens with the impractical task of determining which party is the true lender in such a partnership. Several commenters stated that the FDIC should establish rules for making this determination. The proposal did not address the circumstances under which a non-bank might be the true lender with respect to a loan, and did not allocate the task of making such a determination to any party. Given the policy issues associated with this type of partnership, consideration separate from this rulemaking is warranted. However, that should not delay this rulemaking, which addresses the need to clarify the interest rates that may be charged with respect to State banks' loans and promotes the safety and soundness of State banks.

One commenter recommended that the FDIC revise the text of its proposed rule to reflect the intention not to preempt the true lender doctrine, suggesting that this was important to ensure that the rule is not used in a manner that exceeds the FDIC's stated intent. The FDIC believes that the text of the proposed regulation cannot be reasonably interpreted to foreclose true lender claims. The rule specifies the point in time when it is determined whether interest on a loan is permissible under section 27, but this is premised upon a State bank having made the loan. Moreover, including a specific reference to the true lender doctrine in the regulation could be interpreted to unintentionally limit its use, as courts might refer to this doctrine using different terms. Therefore, as discussed in the NPR, the rule does 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.

Commenters also asserted that the FDIC's statement in the preamble to the proposed rule that it views unfavorably certain relationships between banks and non-banks does not square with the failure of regulators to sufficiently address instances of predatory lending. The FDIC

believes that this rulemaking does not provide the appropriate avenue to address concerns regarding predatory lending by specific parties. The FDIC believes that it is important to put in place a workable rule clarifying the application of section 27. As discussed above, the proposal is not intended to foreclose remedies available under State law if there are concerns that particular banks or non-banks are violating State law interest rate limits.

#### **D. Effect of Opt Out by a State**

A commenter requested that the FDIC clarify how the proposed rule would interact with the right of states to opt out of section 27. As noted in the proposal, pursuant to section 525 of DIDCMA,<sup>62</sup> 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. If a State opts out, neither section 27 nor its implementing regulations would apply to loans made in the State. In so far as these regulations codify existing law and interpretations of section 27, as reflected in FDIC General Counsel's Opinion No. 10 and 11, and are patterned after the equivalent regulations applicable to national banks, such interpretations would not apply with respect to loans made in a State that has elected to override section 27. These interpretations include the most favored lender doctrine, interest rate exportation, and the federal definition of interest.<sup>63</sup> Accordingly, if a State opts out of section 27, State banks making loans in that State could not charge interest at a rate exceeding the limit set by the State's laws, even if the law of the State where the State bank is located would permit a higher rate.

#### **E. Other Technical Changes**

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<sup>62</sup> 12 U.S.C. 1831d note.

<sup>63</sup> See 12 CFR 331.4(a) and (b), and 12 CFR 331.2, respectively.

Several commenters noted that the text of the FDIC’s proposed regulations implementing section 27, and specifically proposed § 331.4(e), differed in certain respects from the regulations proposed by the OCC to implement section 85. Commenters suggested that this variance risks different judicial interpretations of statutes that have historically been interpreted *in pari materia*, and recommended that the agencies harmonize the language of these provisions to reinforce that they accomplish the same result.

The FDIC seeks through this rulemaking to maintain parity between State banks and national banks with respect to interest rate authority. Section 27 has consistently been applied to State banks in the same manner as section 85 has been applied to national banks. The proposed rule is implementing section 27 by adopting a rule that is parallel to those rules adopted by the OCC. The OCC has amended its rules to provide that interest on a loan that is permissible under section 85 and 1463(g)(1), respectively, shall not be affected by the sale, assignment, or other transfer of the loan. Ultimately, the objective and effect of the OCC’s rule is fundamentally the same as the FDIC’s proposed rule – to reaffirm that banks may assign their loans without impacting the validity or enforceability of the interest.

In response to commenters’ concerns, the FDIC is adopting non-substantive revisions to the text of § 331.4(e). Specifically, the second sentence of § 331.4(e) will be more closely aligned with the text of the OCC’s regulation. As a result, section 331.4(e) of the final rule provides: “Whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made. Interest on a loan that is permissible under section 27 of the Federal Deposit Insurance Act shall 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.” These changes should not result in different outcomes from the proposed rule.

A commenter suggested that the FDIC should consider clarifying the proposed rule to state that all price terms (including fees) on State banks' loans under section 27 remain valid upon sale, transfer, or assignment. The FDIC believes that the text of the proposed rule addresses this issue, as § 331.2 broadly defined the term "interest" for purposes of the rule to include fees. Therefore, fees that are permitted under the law of the State where the State bank is located would remain enforceable following the sale, transfer, or assignment of a State bank's loan.

Another commenter suggested that the FDIC clarify that the application of section 331.4(e) of the proposed rule would also include circumstances where a State bank has sold, assigned, or transferred an interest in a loan. The FDIC agrees that the sale, assignment, or transfer of a partial interest in a loan would fall within the scope of proposed section 331.4(e), and the loan's interest rate terms would continue to be enforceable following such a transaction, and has made a clarifying change to the regulatory text to ensure there is no ambiguity.

#### **IV. Description of the Final Rule**

##### **A. Application of Host State Law**

Section 331.3 of the final rule implements section 24(j)(1) of the FDI Act, which establishes parity between State banks and national banks regarding the application of State law to interstate branches. If a State bank maintains a branch in a State other than its *home State*, the bank is an *out-of-State State bank* with respect to that State, which is designated the *host State*. A State bank's *home State* is defined as the State that chartered the Bank, and a *host State* is another State in which that bank maintains a branch. These definitions correspond with statutory

definitions of these terms used by section 24(j).<sup>64</sup> Consistent with section 24(j)(1), the final rule provides that the laws of a host State apply to a branch of an out-of-State State bank only to the extent such laws apply to a branch of an out-of-State national bank in the host State. Thus, to the extent that host State law is preempted for out-of-State national banks, it is also preempted with respect to out-of-State State banks.

## **B. Interest Rate Authority**

Section 331.4 of the final rule implements section 27 of the FDI Act, which provides parity between State banks and national banks regarding the applicability of State law interest-rate restrictions. Paragraph (a) corresponds with section 27(a) of the statute, and provides that a State bank or insured branch of a foreign bank may charge interest of up to the greater of: 1 percent more than the rate on 90-day commercial paper rate; or the rate allowed by the law of the State where the bank is located. Where a State constitutional provision or statute prohibits a State bank or insured branch of a foreign bank from charging interest at the greater of these two rates, the State constitutional provision or statute is expressly preempted by section 27.

In some instances, State law may provide different interest-rate restrictions for specific classes of institutions and loans. Paragraph (b) clarifies the applicability of such restrictions to State banks and insured branches of foreign banks. State banks and insured branches of foreign banks located in a State are permitted to charge interest at the maximum rate permitted to any State-chartered or licensed lending institution by the law of that State. Further, a State bank or insured branch of a foreign bank is subject only to the provisions of State law relating to the class of loans that are material to the determination of the permitted interest rate. For example,

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<sup>64</sup> Section 24(j)(4) references definitions in section 44(f) of the FDI Act; however, the Gramm-Leach-Bliley Act redesignated section 44(f) as section 44(g) without updating this reference. The relevant definitions are currently found in section 44(g), 12 U.S.C. 1831u(g).



assume that a State's laws allow small State-chartered loan companies to charge interest at specific rates, and impose size limitations on such loans. State banks or insured branches of foreign banks located in that State could charge interest at the rate permitted for small State-chartered loan companies without being so licensed. However, in making loans for which that interest rate is permitted, State banks and insured branches of foreign banks would be subject to loan size limitations applicable to small State-chartered loan companies under that State's law. This provision of the final rule is intended to maintain parity between State banks and national banks, and corresponds with the authority provided to national banks under the OCC's regulations at 12 C.F.R. § 7.4001(b).

Paragraph (c) of section 331.4 clarifies the effect of the final rule's definition of the term *interest* for purposes of State law. Importantly, the final rule's definition of *interest* does not change how interest is defined by the State or how the State's definition of interest is used solely for purposes of State law. For example, if late fees are not interest under State law where a State bank is located but State law permits its most favored lender to charge late fees, then a State bank located in that State may charge late fees to its intrastate customers. The State bank also may charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under State law where the State bank is located. However, the late fees are not treated as interest for purposes of evaluating compliance with State usury limitations because State law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations. This provision of the final rule corresponds to a similar provision in the OCC's regulations, 12 C.F.R. § 7.4001(c).

Paragraph (d) of section 331.4 clarifies the authority of State banks and insured branches of foreign banks to charge interest to corporate borrowers. If the law of the State in which the State bank or insured branch of a foreign bank is located denies the defense of usury to corporate

borrowers, then the State bank or insured branch is permitted to charge any rate of interest agreed upon by a corporate borrower. This provision is also intended to maintain parity between State banks and national banks, and corresponds to authority provided to national banks under the OCC's regulations, at 12 C.F.R. § 7.4001(d).

Paragraph (e) clarifies that the determination of whether interest on a loan is permissible under section 27 of the FDI Act is made at the time the loan is made. This paragraph further clarifies that interest on a loan permissible under section 27 shall not be affected by a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan, in whole or in part. An assignee can enforce the loan's interest-rate terms to the same extent as the assignor. Paragraph (e) is not intended to affect the application of State law in determining 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 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).

## **V. Expected Effects**

The final rule is intended to address uncertainty regarding the applicability of State law interest rate restrictions to State banks and other market participants. The final rule would reaffirm the ability of State banks to sell and securitize loans they originate. Therefore, as described in more detail below, the final rule should mitigate the potential for future disruption to the markets for loan sales and securitizations, including FDIC-R loan sales and securitizations, and a resulting contraction in availability of consumer credit.

Beneficial effects on availability of consumer credit and securitization markets would fall into two categories. First, the rule would mitigate the possibility that State banks' and FDIC-R's

ability to sell loans might be impaired in the future. Second, the rule could have immediate effects on certain types of loans and business models in the Second Circuit that may have been directly affected by the *Madden* decision and outlined by studies raised by commenters.

With regard to these two types of benefits, the *Madden* decision created significant uncertainty in the minds of market participants about banks' future ability to sell loans. For example, one commentator stated, "[T]he impact on depository institutions will be significant even if the application of the *Madden* decision is limited to third parties that purchase charged off debts. Depository institutions will likely see a reduction in their ability to sell loans originated in the Second Circuit due to significant pricing adjustments in the secondary market."<sup>65</sup> Such uncertainty has the potential to chill State banks' willingness to make the types of loans affected by the final rule. By reducing such uncertainty, the final rule should mitigate the potential for future reductions in the availability of credit.

More specifically, some researchers have focused attention on the impact of the decision on so-called marketplace lenders. Since marketplace lending frequently involves a partnership in which a bank originates and immediately sells loans to a nonbank partner, any question about the nonbank's ability to enforce the contractual interest rate could adversely affect the viability of that business model. Thus, for example, regarding the Supreme Court's decision not to hear the appeal of the *Madden* decision, Moody's wrote: "The denial of the appeal is generally credit negative for marketplace loans and related asset-backed securities (ABS), because it will extend the uncertainty over whether state usury laws apply to consumer loans facilitated by lending

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<sup>65</sup> "*Madden v. Midland Funding: A Sea Change in Secondary Lending Markets*," Robert Savoie, McGlinchey Stafford PLLC, p. 3.

platforms that use a partner bank origination model.”<sup>66</sup> In a related vein, some researchers have stated that marketplace lenders in the affected States did not grow their loans as fast in these states as they did in other States, and that there were pronounced reductions of credit to higher risk borrowers.<sup>67</sup>

Particularly in jurisdictions affected by *Madden*, to the extent the final rule results in the preemption of State usury laws, some consumers may benefit from the improved availability of credit from State banks. For these consumers, this additional credit may be offered at a higher interest rate than otherwise provided by relevant State law. However, in the absence of the final rule, these consumers might be unable to obtain credit from State banks and might instead borrow at higher interest rates from less-regulated lenders.

The FDIC also believes that an important benefit of the final rule is to uphold longstanding principles regarding the ability of banks to sell loans, an ability that has important safety-and-soundness benefits. By reaffirming the ability of State banks to assign loans at the contractual interest rate, the final rule should make State banks’ loans more marketable, enhancing State banks’ ability to maintain adequate capital and liquidity levels. Avoiding disruption in the market for loans is a safety and soundness issue, as affected State banks would maintain the ability to sell loans they originate in order to properly maintain liquidity. Avoiding such disruption would also maintain the FDIC’s ability to fulfill its mission to maintain stability and public confidence in the nation’s financial system by carrying out all of the tasks triggered

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<sup>66</sup> Moody’s Investors Service, “Uncertainty Lingers as Supreme Court Declines to Hear *Madden* Case” (Jun. 29, 2016).

<sup>67</sup> See Colleen Honigsberg, Robert Jackson and Richard Squire, “How Does Legal Enforceability Affect Consumer lending? Evidence from a Natural Experiment,” *Journal of Law and Economics*, vol. 60 (November 2017); and Piotr Danisewicz and Ilaf Elard, “The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy” (July 5, 2018). Available at <http://ssrn.com/abstract=3209808> or <http://dx.doi.org/10.2139/ssrn.3208908>.

by the closure of an FDIC-insured institution, including selling portfolio of loans from failed financial institutions in the secondary marketplace in order to maximize the net present value return from the sale or disposition of such assets and minimize the amount of any loss, both in order to protect the DIF. Additionally, securitizing or selling loans gives State banks flexibility to comply with risk-based capital requirements.

Similarly, the final rule is expected to preserve State banks' ability to manage their liquidity. This is important for a number of reasons. For example, the ability to sell loans allows State banks to increase their liquidity in a crisis, to meet unusual deposit withdrawal demands, or to pay unexpected debts. The practice is useful for many State banks, including those that prefer to hold loans to maturity. Any State bank could be faced with an unexpected need to pay large debts or deposit withdrawals, and the ability to sell or securitize loans is a useful tool in such circumstances.

The final rule would also support State banks' ability to use loan sales and securitization to diversify their funding sources and address interest-rate risk. The market for loan sales and securitization is a lower-cost source of funding for State banks, and the proposed rule would support State banks' access to this market.

Finally, to the extent the final rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, the FDIC does not expect immediate widespread effects on credit availability. While several commenters cited to studies discussing the adverse effects of *Madden* in the Second Circuit, as well as anecdotal evidence of increased difficulty selling loans made to borrowers in the Second Circuit post-*Madden*, 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. However, courts across the country continue to address legal questions raised in the

*Madden* decision, raising the possibility that future decisions will put further pressure on credit availability or securitization markets, reinforcing the need for clarification by the FDIC.<sup>68</sup>

## **VI. Regulatory Analysis**

### **A. Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a final rulemaking, an agency prepare and make available for public comment a final regulatory flexibility analysis that describes the impact of the rule on small entities.<sup>69</sup> However, a final regulatory flexibility analysis is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.<sup>70</sup> The Small Business Administration (SBA) has defined “small entities” to include banking organizations with total assets of less than or equal to \$600 million.<sup>71</sup>

Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or 2.5 percent of total non-interest expenses. The FDIC believes that effects in excess of these thresholds typically represent significant effects for FDIC-supervised institutions. The FDIC has considered the potential

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<sup>68</sup> Compare *In re Rent Rite Superkegs West, Ltd.* 603 B.R. 41 (Bankr. Colo. 2019) (holding assignment of a loan by a bank to a non-bank did not render the interest rate impermissible under Colorado law based upon 12 U.S.C. § 1831d) with *Fulford v. Marlette Funding, LLC*, No. 2017-CV-30376 (Col. Dist. Ct. City & County of Denver, Mar. 3, 2017) (holding that the non-bank purchasers are prohibited under COLO. REV. STAT. § 5-2-201 from charging interest rates in the designated loans in excess of Colorado’s interest caps, that a bank cannot export its interest rate to a nonbank, and finally, that the Colorado statute is not preempted by Section 27).

<sup>69</sup> 5 U.S.C. 601 *et seq.*

<sup>70</sup> 5 U.S.C. 605(b).

<sup>71</sup> The SBA defines a small banking organization as having \$600 million or less in assets, where an organization’s “assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.” See 13 CFR 121.201 (as amended, effective August 19, 2019). In its determination, the SBA “counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.” 13 CFR 121.103. Following these regulations, the FDIC uses a covered entity’s affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the covered entity is “small” for the purposes of RFA.

impact of the final rule on small entities in accordance with the RFA. Based on its analysis and for the reasons stated below, the FDIC certifies that the final rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the FDIC is presenting this additional information.

### *Reasons Why This Action Is Being Considered*

The Second Circuit's *Madden* decision has created uncertainty as to the ability of an assignee to enforce the interest rate provisions of a loan originated by a bank. *Madden* held that, under the facts presented in that case, nonbank debt collectors who purchase debt<sup>72</sup> from national banks are subject to usury laws of the debtor's State<sup>73</sup> and do not inherit the preemption protection vested in the assignor national bank because such State usury laws do not "significantly interfere with a national bank's ability to exercise its power under the [National Bank Act]."<sup>74</sup> The court's decision created uncertainty and a lack of uniformity in secondary credit markets. For additional discussion of the reasons why this rulemaking is being proposed please refer to **SUPPLEMENTARY INFORMATION** Section II in this **Federal Register** Notice entitled "Background: Current Regulatory Approach and Market Environment."

### *Objectives and Legal Basis*

The policy objective of the final rule is to eliminate uncertainty regarding the enforceability of loans originated and sold by State banks. The FDIC is proposing regulations that would implement sections 24(j) and 27 of the FDI Act. For additional discussion of the

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<sup>72</sup> In *Madden*, the relevant debt was a consumer debt (credit card) account.

<sup>73</sup> A violation of New York's usury laws also subjected the debt collector to potential liability imposed under the Fair Debt Collection Practices Act, 15 U.S.C. 1692e, 1692f.

<sup>74</sup> *Madden*, 786 F.3d at 251 (referencing *Barnett Bank of Marion City, N.A. v. Nelson*, 517 U.S. 25, 33 (1996); *Pac. Capital Bank*, 542 F.3d at 533).

objectives and legal basis of the final rule please refer to the **SUPPLEMENTARY INFORMATION** sections I and II entitled “Policy Objectives” and “Background: Current Regulatory Approach and Market Environment,” respectively.

#### *Number of Small Entities Affected*

As of December 31, 2019, there were 3,740 State-chartered banks insured by the FDIC, of which 2,847 have been identified as “small entities” in accordance with the RFA.<sup>75</sup> All 2,847 small State-chartered FDIC-insured banks are covered by the final rule, and therefore, could be affected. However, only 32 small State-chartered FDIC-insured banks are chartered in States within the Second Circuit (New York, Connecticut and Vermont) and therefore, may have been directly affected by ambiguities about the practical implications of the *Madden* decision. Moreover, only State banks actively engaged in, or considering making loans for which the contractual interest rates could exceed State usury limits, would be affected by the proposed rule. Small State-chartered banks that are chartered in States outside the Second Circuit, but that have made loans to borrowers who reside in New York, Connecticut and Vermont also may be directly affected, but only to the extent they are engaged in or considering making loans for which contractual interest rates could exceed State usury limits. It is difficult to estimate the number of small entities that have been directly affected by ambiguity resulting from *Madden* and would be affected by the proposed rule without complete and up-to-date information on the contractual terms of loans and leases held by small State-chartered banks, as well as present and future plans to sell or transfer assets. The FDIC does not have this information.

#### *Expected Effects*

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<sup>75</sup> FDIC Call Report Data, December 31st, 2019.



The final rule clarifies that the determination of whether interest on a loan is permissible under section 27 of the FDI Act is made when the loan is made, and that the permissibility of interest under section 27 is not affected by subsequent events such as changes in State law or assignment of the loan. As described below, this would be expected to increase some small State banks' willingness to make loans with contractual interest rates that could exceed limits prescribed by State usury laws, either at inception or contingent on loan performance.

As described above, the significant uncertainty resulting from *Madden* may discourage the origination and sale of loan products whose contractual interest rates could potentially exceed State usury limits by small State-chartered banks in the Second Circuit. The final rule could increase the availability of such loans from State banks, but the FDIC believes the number of State banks materially engaged in making loans of this type to be small.

The small State-chartered banks that are affected would benefit from the ability to sell such loans while assigning to the buyer the right to enforce the contractual loan interest rate. Without the ability to assign the right to enforce the contractual interest rate, the sale value of such loans would be substantially diminished. The final rule does not pose any new reporting, recordkeeping, or other compliance requirements for small State banks.

#### *Duplicative, Overlapping, or Conflicting Federal Regulations*

The FDIC has not identified any Federal statutes or regulations that would duplicate, overlap, or conflict with the proposed revisions.

#### *Public Comments*

The FDIC received no public comments on the content of the RFA section of the Notice of Proposed Rulemaking. However, some commenters made general claims that the rule would

adversely impact small businesses.<sup>76</sup> As noted above in the discussion of comments, this concern appears to stem from perceived abuses of longstanding statutory authority rather than the final rule. Because the final rule affirms the pre-*Madden* status quo, the FDIC expects small businesses to be as affected by the rule to the same extent they were affected by the state of affairs which prevailed prior to the *Madden* decision. For a discussion of the comments submitted in response to the Notice of Proposed Rulemaking in general, refer to Section III of this Notice.

#### *Discussion of Significant Alternatives*

The FDIC believes the amendments will not have a significant economic impact on a substantial number of small State banks, and therefore believes that there are no significant alternatives to the amendments that would reduce the economic impact on small entities.

#### **B. Congressional Review Act**

[Describe Major Rule analysis. The FDIC will submit the final rule and other appropriate reports to Congress and the Government Accountability Office for review.]

#### **C. Paperwork Reduction Act of 1995**

In accordance with the requirements of the Paperwork Reduction Act of 1995,<sup>77</sup> the FDIC may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The final rule does not require any new information collections or revise existing information collections, and therefore, no submission to OMB is necessary.

#### **D. Riegle Community Development and Regulatory Improvement Act**

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<sup>76</sup> See Comment Letter, Center for Responsible Lending, et al., at 31.

<sup>77</sup> 44 U.S.C. 3501 *et seq.*

Section 302 of the Riegle Community Development and Regulatory Improvement Act (RCDRIA) requires that the Federal banking agencies, including the FDIC, in determining the effective date and administrative compliance requirements of new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations.<sup>78</sup> Subject to certain exceptions, new regulations and amendments to regulations prescribed by a Federal banking agency which impose additional reporting, disclosures, or other new requirements on insured depository institutions shall take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form.<sup>79</sup>

The final rule does not impose additional reporting or disclosure requirements on insured depository institutions, including small depository institutions, or on the customers of depository institutions. Accordingly, the FDIC concludes that section 302 of RCDRIA does not apply. The FDIC invited comment regarding the application of RCDRIA to the final rule, but did not receive comments on this topic.

#### **E. The Treasury and General Government Appropriations Act, 1999 – Assessment of Federal Regulations and Policies on Families**

The FDIC has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as

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<sup>78</sup> 12 U.S.C. 4802(a).

<sup>79</sup> 12 U.S.C. 4802(b).

part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Public Law 105-277, 112 Stat. 2681.

#### **F. Plain Language**

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106-102, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rulemakings published in the Federal Register after January 1, 2000. FDIC staff believes the final rule is presented in a simple and straightforward manner. The FDIC invited comment with respect to the use of plain language, but did not receive any comments on this topic.

#### **List of Subjects in 12 CFR Part 331**

Banks, banking, deposits, foreign banking, interest rates.

#### **Authority and Issuance**

For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation amends Part 331 of title 12 of the Code of Federal Regulations as follows:

#### **PART 331 – FEDERAL INTEREST RATE AUTHORITY**

##### Contents

331.1 Authority, purpose, and scope.

331.2 Definitions.

331.3 Application of host State law.

331.4 Interest rate authority.

Authority: 12 U.S.C. 1819(a)(Tenth), 1820(g), 1831d.

### **§ 331.1 Authority, purpose, and scope.**

(a) *Authority.* The regulations in this part are issued by the FDIC under sections 9(a)(Tenth) and 10(g) of the Federal Deposit Insurance Act (“FDI Act”), 12 U.S.C. 1819(a)(Tenth), 1820(g), to implement sections 24(j) and 27 of the FDI Act, 12 U.S.C. 1831a(j), 1831d, and related provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980, Public Law 96-221, 94 Stat. 132 (1980).

(b) *Purpose.* Section 24(j) of the FDI Act, as amended by the Riegle-Neal Amendments Act of 1997, Public Law 105-24, 111 Stat. 238 (1997), was enacted to maintain parity between State banks and national banks regarding the application of a host State’s laws to branches of out-of-State banks. Section 27 of the FDI Act was enacted to provide State banks with interest rate authority similar to that provided to national banks under the National Bank Act, 12 U.S.C. 85. The regulations in this part clarify that State-chartered banks and insured branches of foreign banks have regulatory authority in these areas parallel to the authority of national banks under regulations issued by the Office of the Comptroller of the Currency, and address other issues the FDIC considers appropriate to implement these statutes.

(c) *Scope.* The regulations in this part apply to State-chartered banks and insured branches of foreign banks.

### **§ 331.2 Definitions.**

For purposes of this part—

(a) *Home State* means, with respect to a State bank, the State by which the bank is chartered.

(b) *Host State* means a State, other than the home State of a State bank, in which the State bank maintains a branch.

(c) *Insured branch* has the same meaning as that term in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. § 1813.

(d) *Interest* means any payment compensating a creditor or prospective creditor for an extension of credit, making available a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. Interest includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates; late fees; creditor-imposed not sufficient funds (NSF) fees charged when a borrower tenders payment on a debt with a check drawn on insufficient funds; overlimit fees; annual fees; cash advance fees; and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

(e) *Out-of-State State bank* means, with respect to any State, a State bank whose home State is another State.

(f) *Rate on ninety-day commercial paper* means the rate quoted by the Federal Reserve Board of Governors for ninety-day A2/P2 nonfinancial commercial paper.

(g) *State bank* has the same meaning as that term in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. § 1813.

### **§ 331.3 Application of host State law.**

The laws of a host State, shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank. To the extent host State law is inapplicable to a branch of an out-of-State State bank in such host State pursuant to the preceding sentence, home State law shall apply to such branch.

#### **§ 331.4 Interest rate authority.**

(a) *Interest rates.* In order to prevent discrimination against State-chartered depository institutions, including insured savings banks, or insured branches of foreign banks, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this paragraph, such State bank or insured branch of a foreign bank may, notwithstanding any State constitution or statute which is preempted by section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d, 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 a rate of not more than 1 percent in excess of the rate on ninety-day commercial paper or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.

(b) *Classes of institutions and loans.* A State bank or insured branch of a foreign bank located in a State may charge interest at the maximum rate permitted to any State-chartered or licensed lending institution by the law of that State. If State law permits different interest charges on specified classes of loans, a State bank or insured branch of a foreign bank making such loans is subject only to the provisions of State law relating to that class of loans that are material to the determination of the permitted interest. For example, a State bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company, without being so licensed, but subject to State law limitations on the size of loans made by small loan companies.

(c) *Effect on State law definitions of interest.* The definition of the term *interest* in this part does not change how interest is defined by the individual States or how the State definition of interest is used solely for purposes of State law. For example, if late fees are not *interest* under the State law of the State where a State bank is located but State law permits its most favored

lender to charge late fees, then a State bank located in that State may charge late fees to its intrastate customers. The State bank also may charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under the State law of the State where the bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with State usury limitations because State law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

(d) *Corporate borrowers.* A State bank or insured branch of a foreign bank located in a State whose State law denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by the corporate borrower.

(e) *Determination of interest permissible under section 27.* Whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made. Interest on a loan that is permissible under section 27 of the Federal Deposit Insurance Act shall 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.

Dated at Washington, D.C., this 25th day of June, 2020.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary