DIDMCA

Key Messages

Policymakers in Washington DC and elsewhere should be aware that opting out of federal usury preemption under the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), does not guarantee elimination of the bank partnership model and carries with it a host of unrelated negative consequences, undermining the competitive balance between national banks and state-chartered banks, stifling innovation, hampering home-grown state-chartered banks, limiting consumer choice, and raising the cost of credit for citizens.

Topline Messages

Now is not the time for Washington DC to rethink DIDMCA. DIDMCA's federal preemption helped alleviate pressure from the high interest rate environment of the late 1970s. Decades later, in another high interest rate environment, the cost of funds for lenders has risen significantly.

Consumer activists and some policymakers believe opting out of DIDMCA will prevent interstate bank partnership lending, but this is not inevitable, though a raft of damaging secondary effects and unintended consequences is guaranteed.

Opting out of DIDMCA will exacerbate existing credit access issues for hardworking individuals and families, without materially affecting the viability of the so-called bank partnership model.

Sub-Messages and Proof Points

Now is not the time for Washington DC to rethink DIDMCA. DIDMCA's federal preemption helped alleviate pressure from the high-interest rate environment of the late 1970s. Decades later, in another high interest rate environment, the cost of funds for lenders has risen significantly.

Prior to DIDMCA's passage, interest rates were rising, but state rate caps prevented domestic state-charted banks from adjusting their interest rates in-line with higher cost of funds.[i]

- This created a competitive advantage for federally chartered banks in states where rate caps apply, because national banks enjoyed a secondary variable rate option as well as most favored lender authority, allowing them to match the rate allowed the most favored competing domestic lenders which was unavailable to state banks.
- Without DIDMCA, state-chartered institutions cannot compete with federal institutions.
- Opting out of DIDMCA will return states to the restricted domestic credit markets that existed prior.

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After DIDMCA's passage, some states opted out of the rate preemption. Every state that opted out, with a single exception (Iowa), subsequently opted back in, as the harmful effects of opting out became clear. Some states, including Iowa, gradually deregulated their domestic laws over time, largely rendering their DIDMCA opt-outs meaningless until finally repealed.

- Today, even Iowa has largely deregulated its rates and fees for consumer credit with the exception of a 21% rate cap on installment lending, greatly limiting the adverse effects of the state's opt-out.

States repealed their DIDMCA opt-outs because the institutions most directly affected are *domestic* (not interstate) state-chartered banks.

- As federal statutes both DIDMCA Section 525 (opt out) and Section 521 (state rate authority) are subject to definition and interpretation under *federal* law.
- State law cannot influence federal law except as expressly incorporated into federal law.[ii] Federal law alone determines where a loan is made, for DIDMCA purposes.[iii]

DIDMCA alternative rate authority for state-chartered banks has worked well. State-chartered institutions, like federally chartered institutions, are currently able to innovate and compete on a level playing field, in ways that ultimately benefit states' domestic economies, consumers, and small businesses.

- Currently, DIDMCA helps prevent market disruptions that could limit credit access.
- Opting out leaves federally chartered institutions unaffected, free to export interest rates and match competitors, while state-chartered institutions must operate under inflexible and restrictive state laws that can render them uncompetitive in the marketplace.
- This affects both consumer credit availability and the institutions' ultimate safety and soundness.
- A similar situation could result from an associated two-tier system for federal- and state-chartered Credit Unions.

Opting out of DIDMCA is unnecessary, as bank-originated loans are safe and state-chartered institutions are subject to regular and intensive examinations by both federal and state regulators.

- Federal and state banking regulators, state attorneys general and private litigation all have the power to initiate actions against state-chartered institutions that work with non-banks in a way that is unfair, deceptive, or abusive.
- FDIC-insured banks are subject to heavy federal scrutiny, further ensuring safety and fairness.

Consumer activists and some policymakers believe opting out of DIDMCA will prevent bank partnership lending, but this is not inevitable, though a raft of damaging secondary effects and unintended consequences is guaranteed.

A DIDMCA opt-out would restrict only state-chartered institutions and do nothing to address any partnership lending by national banks or tribal lenders.

Opting out of DIDMCA may not have the impact some seek, affecting only loans deemed "made in" the opt-out state.

- Out-of-state originating banks will have very strong arguments that their loans are originated in their "home" states and, thus, unaffected by a state's opt-out.

As written, the Washington DC legislation is overly broad and likely to be unenforceable. At the very least, it will likely result in burdensome litigation on behalf of affected institutions.

- While a bank chartered in a state that has opted out would be prevented from exporting its state rates into other states, it is possible that a court would rule that banks chartered in other states would not automatically be prevented from exporting rates into an opt-out state. depending on specific facts surrounding a loan.
- This uncertainty could curtail certain kinds of desirable lending.
- The lack of case law on this issue further indicates to the likelihood of litigation.

Enacting a DIDMCA opt-out simply handcuffs domestic institutions in the short term, ultimately harming domestic consumers by depriving them of access to credit on an interstate basis. Many common products like credit cards are reliant upon economics of scale that domestic banks cannot replicate.

Many financial institutions maintain state-chartered banks for specific types of lending, including vehicle financing and issuing credit cards.

- DIDMCA opt-outs will force these banks to restrict credit to those who need it most.

There are also legal questions related to whether the right to opt-out of DIDMCA still exists.

- It is possible that Section 407 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) *repealed* Section 525 of DIDMCA, which would mean states no longer can opt-out. At least two cases support this conclusion.[iv]

Opting out of DIDMCA also makes domestic state-chartered banks less competitive on an interstate basis.

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- DIDMCA was originally enacted to help *domestic* state-chartered institutions at a time when *interstate* lending by state-chartered institutions was not a significant consideration, although the adoption of substantially similar rate language to that available to national banks opened the interstate lending market to state-chartered institutions, again, leveling the playing field between state-chartered banks and national banks.
- Interstate lending *also* allows domestic banks to diversify their loan portfolios geographically, enhancing their overall safety and soundness to the benefit of these institutions, their regulators (and FDIC bank insurance funds) and their customers.

Opting out of DIDMCA will exacerbate existing credit access issues for hardworking individuals and families, without materially affecting the viability of the so-called bank partnership model.

Opting out will harm consumers who need credit most.

- Restrictions on state-chartered institutions translate into restrictions on consumers.
- The resulting reduction in available credit will leave demand for credit unfulfilled.
- Opting out will also reduce competition in the marketplace by creating a more uneven playing field among state-charted and national institutions, potentially raising the cost of credit.

Wide access to credit-building loans can be an effective economic tool for empowering individuals and families, driving financial mobility, and increasing prosperity. This is good for local communities and our national and state economies.

- The demand for credit will not go away in states that opt-out of DIDMCA.
- Opting out will make it impossible for state-chartered institutions to make sustainable loans.
- Consumers may be forced to seek credit in neighboring states or use unregulated or illegal local or online sources for the credit they need.

Many states are already dealing with “credit deserts” where the availability of financial services is limited; opting out of DIDMCA will make this situation worse.

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[i] The U.S. Supreme Court's decision in *Marquette Nat'l Bank. v. First Omaha Serv. Corp.*, 439 U.S. 299 (1978), had not yet had a material effect on interstate lending, and the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 and its progeny had not yet been enacted to facilitate wider bank branching.

[ii] *See Greenwood Trust Co. v. Massachusetts*, 776 F. Supp. 21 (D. Mass. 1991), *rev'd on other grounds*, 971 F.2d 818 (1st Cir. 1992) ("In general, the words and phrases contained in a federal statute are defined by reference to federal law. *See Mississippi Band of Choctaw Indians v. Holyfield,* 490 U.S. 30, 43, 109 S.Ct. 1597, 1605, 104 L.Ed.2d 29 (1989); *Jerome v. United States,* 318 U.S. 101, 104, 63 S.Ct. 483, 485, 87 L.Ed. 640 (1943). There are two compelling reasons for adhering to this praxis. First, application of state-law definitions may threaten the policies or interests which a federal statute is designed to serve. *See United States v. Kimbell Foods, Inc.,* 440 U.S. 715, 728, 99 S.Ct. 1448, 1458, 59 L.Ed.2d 711 (1979); *Burks v. Lasker,* 441 U.S. 471, 479, 99 S.Ct. 1831, 1837, 60 L.Ed.2d 404 (1979). Second, application of state-law definitions may disrupt Congress's desire for nationwide uniformity under a federal statute. *See Kamen v. Kemper Fin. Servs., Inc.,* ___ U.S. ___, ___, 111 S.Ct. 1711, 1717, 114 L.Ed.2d 152 (1991); *Mississippi Band,* 490 U.S. at 43-44, 109 S.Ct. at 1605-06."), *cert. denied*, 506 U.S. 1052 (1993); 828 ("[T]he language borrowed from Bank Act § 85 and incorporated into DIDA § 521 achieves parity between national banks and their state-chartered counterparts by allowing lenders such as Greenwood to choose among three interest rate ceilings: (1) the highest rate lawfully permitted without reference to section 521; (2) a rate not more than one percent above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the federal reserve district where the lender is located; or (3) the highest rate allowed by the laws of the state where the lender is located. Section 521's express preemption clause is designed to maintain this parity. Acting in combination with the principle of exportation, this clause necessarily derails any state-sponsored attempt to regulate the maximum interest chargeable by a federally insured bank chartered in another state. For our purposes, this means that any Massachusetts law applicable to Greenwood must yield to the preemptory force of section 521 insofar as the regulation of "interest" is concerned.").

[iii] *See* 12 C.F.R. § 331.4; Op. 11, FDIC Gen. Counsel, 63 Fed. Reg. 27282-27286, n.26-27 and accompanying text (1998) (citing Senator Roth on congressional intent); FDIC Letter No. 88-45 from Douglas H. Jones, Deputy Gen. Counsel (June 29, 1988), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,110 [(i) the fact that a state has opted out of federal interest rate preemption under the Section 525 "countermand" should not affect the usury preemption of Section 521 for a bank not located in that state, so long as the loan is not made in the state that has countermanded, (ii) the determination of where a loan is made should be based upon an analysis of the facts surrounding the extension of credit and (iii) relevant factors in the analysis of where loans are made may include factors identified in the Restatement (Second) of Conflict of Laws Sections 188, 195.].

[iv] Stoorman v. Greenwood Trust Co, 888 P.2d 289 (Colo. App. 1994), aff'd, 908 P.2d 133 (Colo. 1995).