

January 21, 2020

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Re: *Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*
Docket ID OCC-2019-0027

The American Financial Services Association (AFSA)¹ appreciates the opportunity to comment on the Office of the Comptroller of the Currency's (OCC) proposed rule regarding permissible interest rates on loans that are sold, assigned, or otherwise transferred (Proposed Rule). As the OCC acknowledges, recent developments have created uncertainty about the ongoing validity of the interest term after a financial institution sells, assigns, or otherwise transfers a loan. AFSA fully supports the Proposed Rule, which will help American consumers by providing much needed clarification in this area.

The Proposed Rule amends 12 CFR 7.4001 and 12 CFR 160.110 by adding a new paragraph that provides that the rate of interest on a loan that is permissible under sections 85 of the National Bank Act (NBA) and 12 U.S.C. § 1463(g)(1), respectively, shall not be affected by the sale, assignment, or other transfer of the loan. The Proposed Rule would expressly codify what the OCC and the financial services industry have always believed and address the recent confusion about the impact of an assignment on the permissible rate of interest.

AFSA's comment focuses on two points: (1) the OCC's interpretation of federal law, as laid out in the Proposed Rule, is correct; and (2) it is in the best interest of consumers for the OCC to promulgate this rulemaking.

On the first point, as the OCC outlines in the Proposed Rule, federal law authorizes national banks to charge interest at the maximum rate permitted to any state-chartered or licensed lending institution in the state where the bank is located. Banks are also permitted to enter into contracts and they are permitted to assign such contracts. Of course, loan agreements are contracts. Thus, banks are clearly authorized to sell, assign, or otherwise transfer loans.

Section 85 of the NBA specifies that the usury limits of a national bank's home state govern loans of that national bank regardless of the state in which the borrower resides, where the collateral is located, or whose law might apply for some other reason. As a result, there has been a longstanding and universally accepted understanding that the NBA preempts the application of state usury laws on loans originated by national banks. This remains true if the national bank holds the loans as an asset or sells them to a third party. Until the U.S. Court of Appeals for the Second Circuit's decision in *Madden v. Midland Funding, LLC*,² no court had failed to apply the basic

¹ Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

² 786 F.3d 246 (2nd Cir. 2015).

rule that usury is determined at the time of loan origination and subsequent events, such as a bank's assignment of a valid loan to another institution, cannot render the loan usurious.

The two circuit courts that disagree with the outcome in *Madden* concur with the well-established interpretation of the NBA. The U.S. Court of Appeals for the Eighth Circuit held that “[c]ourts must look at ‘the originating entity (the bank), and not the ongoing assignee ... in determining whether the NBA applies.’”³ Along the same lines, the U.S. Court of Appeals for the Fifth Circuit found that the applicable law is determined by looking at the loan's originator, the national bank, in determining the continuing preemptive force of the NBA.⁴

Moreover, the U.S. Supreme Court found that the NBA reflects Congress' vision “of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the states.”⁵ The OCC cites another Supreme Court decision in the Proposed Rule in which the Court recognized the longstanding common law “valid-when-made” principle describing it as a “cardinal rule[] in the doctrine of usury.”⁶

Despite that fact that the valid-when-made principle is well-established, the *Madden* decision created uncertainty regarding the ongoing validity of the contracted interest rate after a national bank assigns a loan. This leads us to our second point. Uncertainty in this area harms not only the financial services industry, but is detrimental to consumers. As the Proposed Rule states:

“... banks of all sizes continue to routinely rely on loan assignments and securitization to access alternative funding sources, manage concentrations, improve financial performance ratios, and more efficiently meet customer needs. This risk management tool would be significantly weakened if the permissible interest on assigned loans were uncertain or if assignment of the permissible interest were limited only to third parties that would be subject to the same or higher usury caps.”⁷

While financial institutions are hurt by the uncertainty created by the Second Circuit's decision, the real impact is on consumers who face a decline in credit ability and an increase in the cost of credit as a result of that uncertainty. A leading academic wrote:

“Last year's Second Circuit decision surely made *Madden* happy, but it is unlikely to benefit future borrowers who find themselves in her position. Riskier applicants are more likely to be among those rationed out of the borrower pool. There is, in fact, already evidence that *Madden* has changed the fortunes of borrowers in the three states covered by the Second Circuit's ruling. Those with low credit scores saw loan volumes decline by half in the months after the ruling; for similar borrowers elsewhere in the country, loan volumes more than doubled.”⁸

³ *Phipps v. FDIC*, 417 F.3d 1006, 1013 (8th Cir. 2005) (quoting *Krispin v. May Department Stores Co.*, 218 F.3d 919, 924 (8th Cir. 2000)).

⁴ *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148–149 (5th Cir. 1981).

⁵ *Easton v. Iowa*, 188 U.S. 220, 229 (1903).

⁶ *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833).

⁷ 84 Fed. Reg. 64231.

⁸ Zuluaga, Diego. *Invalid When Made: The District Court's Madden v. Midland Decision*. CATO Institute. March 20, 2018. Available at: <https://www.cato.org/blog/invalid-when-made-district-courts-madden-v-midland-decision>.

A paper by the Mercatus Center at George Mason University examined the impact of the *Madden* decision on credit access. The Mercatus Center found that, “The case has produced considerable fallout in the Second Circuit, including a significant reduction in credit for borrowers with lower credit scores (who would be charged a higher rate).”⁹ The paper cited Professors Colleen Honigsberg, Robert J. Jackson, and Richard Squire, who documented this decline. They found that the number of loans made to less-creditworthy borrowers in the Second Circuit declined by 52 percent. At the same time, the number of loans made to similarly situated borrowers not in the Second Circuit increased by 124 percent.¹⁰

Another study, written and presented at the Philadelphia Federal Reserve by two university researchers, found a positive correlation between the rise in personal bankruptcies in states within the Second Circuit and the decline in marketplace lending.¹¹ “Using monthly data from the U.S. Courts Administrative Office, we show that personal bankruptcy filings rise by 8% more in Connecticut and New York relative to other states following *Madden*. This is driven by an increase in Chapter 7 and 13 bankruptcies.”¹² The same study also found, “Consistent with classical price theory, the interest rate controls imposed by *Madden* result in credit rationing. Lending Club and Prosper, the two largest U.S. marketplace lenders, significantly reduce lending in the affected states. The volume and number of marketplace loans declines by 10% and 13.4%, respectively.”¹³

The Clearing House, the trade association for U.S. payments system, also notes that without corrective action, the cost of credit will increase, while the availability of credit is likely to decrease:

“Thus, while the *Madden* decision might end up decreasing the interest rates charged on some loans, it almost certainly will decrease the availability and increase the cost of credit, particularly for small businesses and lower-income families. Because loans to such borrowers carry greater credit risk, such loans require higher interest rates, thus creating greater exposure to usury limits. If a bank originates such a loan, bank capital regulation has already dramatically increased its cost of holding it, and *Madden* will significantly limit the ability to securitize it.”¹⁴

In fact, the Clearing House explains that the impact of the Second Circuit’s decision is already being felt in the marketplace.

“Some financial institutions have reportedly imposed restrictions on credit facilities used to finance consumer lending, prohibiting loans to borrowers in the Second Circuit if those loans bear interest at rates higher than the state-enacted usury rates. Similar effects have been felt in the securitization market, as firms have removed loans made to borrowers in the Second Circuit from asset-backed securitizations due to usury concerns. And the impact will almost certainly be even greater in the future.”¹⁵

⁹ Knight, Brian. *Risks to Innovative Credit Posed by Emerging Regulatory and Litigation Trends*. Mercatus on Policy. Jan. 2017. Available at: <https://www.mercatus.org/system/files/knight-risks-innovative-credit-mop-v1.pdf>.

¹⁰ *Ibid.*

¹¹ Danisewicz, Piotr and Ilaf Elard. *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy*. July 5, 2018. Available at SSRN: <https://ssrn.com/abstract=3208908> or <http://dx.doi.org/10.2139/ssrn.3208908>.

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ Pidano Paige E. *Bill to correct Madden ruling would benefit consumers*. American Banker. Feb. 28, 2018. Available at: <https://www.americanbanker.com/opinion/bill-to-correct-madden-ruling-would-benefit-consumers>.

¹⁵ *Ibid.*

AFSA strongly supports the OCC's effort to address the confusion in the marketplace directly resulting from the Second Circuit's decision. We believe that the Proposed Rule should be finalized as proposed as soon as possible. If you have any questions, please do not hesitate to contact me by phone at 202-776-7300 or e-mail at cwinslow@afsamail.org.

Sincerely,

A handwritten signature in black ink that reads "Celia Winslow". The signature is written in a cursive, flowing style.

Celia Winslow
Senior Vice President
American Financial Services Association