AMERICAN FINANCIAL SERVICES ASSOCIATION
LAW COMMITTEE
PERSONAL LOAN COMMITTEE
REPORT ON RECENT DEVELOPMENTS
FEBRUARY 11-12, 2020

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      ii. FDIC Proposed Rule - *"In reaffirming and codifying in regulation the valid-when-made doctrine, the proposal 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." Moreover, the FDIC views unfavorably the arrangements in which an entity partners with a State bank for the sole purpose of evading a lower interest rate established under the law of the entity's licensing state(s)."* FDIC Chairman Jelena McWilliams.
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TAB 1

OCC Bulletin 2019-58| November 21, 2019

Permissible Interest on Loans That Are Transferred: Notice of Proposed Rulemaking

Summary

The Office of the Comptroller of the Currency (OCC) is issuing a notice of proposed rulemaking requesting comment on a proposed rule that would clarify that when a national bank or savings association sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer. Comments must be received by January 21, 2020.

To

Chief Executive Officers of All National Banks and Savings Associations; Department and Division Heads; All Examining Personnel; and Other Interested Parties

Note for Community Banks

This proposed rule would apply to all national banks and savings associations (collectively, banks), including community banks.

Highlights

Federal law establishes that banks may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution in the state where the bank is located. Federal law also provides national banks and federal savings associations with the authority to enter into and assign contracts. Well-established authority also authorizes banks to sell, assign, or otherwise transfer loans. Despite these authorities, recent developments have created uncertainty about the ongoing validity of the interest term after a bank sells, assigns, or otherwise transfers a loan. This rule would clarify that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer.

Further Information

Please contact Andra Shuster, Senior Counsel; Karen McSweeney, Special Counsel; or Priscilla Benner, Attorney, Chief Counsel's Office, at (202) 649-5490.

Jonathan V. Gould
Senior Deputy Comptroller and Chief Counsel

Related Link

- Permissible Interest on Loans That are Sold, Assigned, or Otherwise Transferred (PDF)

Proposed Rules

Federal Register
Vol. 84, No. 225
Thursday, November 21, 2019

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 7 and Part 160

[Docket ID OCC–2019–0027]

RIN 1557–AE73

Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: Federal law establishes that national banks and savings associations (banks) may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution in the state where the bank is located. Federal law also provides national banks and Federal savings associations with the authority to enter into and assign contracts. Well-established authority also authorizes banks to sell, assign, or otherwise transfer loans. Despite these clear authorities, recent developments have created uncertainty about the ongoing validity of the interest term after a bank sells, assigns, or otherwise transfers a loan. This rule would clarify that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer.

DATES: Comments must be received by January 21, 2020.

ADDRESSES: Commenters are encouraged to submit comments through the Federal eRulemaking Portal or email, if possible. Please use the title "Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- *Federal eRulemaking Portal—Regulations.gov Classic or Regulations.gov Beta.*

Regulations.gov Classic: Go to *https://www.regulations.gov/*. Enter "Docket ID OCC–2019–0027" in the Search Box and click "Search." Click on "Comment Now" to submit public comments. For help with submitting effective comments please click on "View Commenter's Checklist." Click on the "Help" tab on the *Regulations.gov* home page to get information on using *Regulations.gov,* including instructions for submitting public comments.

Regulations.gov Beta: Go to *https://beta.regulations.gov/* or click "Visit New *Regulations.gov* Site" from the *Regulations.gov* Classic homepage. Enter "Docket ID OCC–2019–0027" in the Search Box and click "Search." Public comments can be submitted via the "Comment" box below the displayed document information or by clicking on the document title and then clicking the "Comment" box on the top-left side of the screen. For help with submitting effective comments please click on "Commenter's Checklist." For assistance with the *Regulations.gov* Beta site, please call (877) 378–5457 (toll free) or (703) 454–9859 Monday–Friday, 9 a.m.–5 p.m. ET or email *regulations@erulemakinghelpdesk.com.*

- *Email: regs.comments@occ.treas.gov.*
- *Mail:* Chief Counsel's Office, Attention: Comment Processing, Office of the Comptroller of the Currency, 400 7th Street SW, Suite 3E–218, Washington, DC 20219.
- *Hand Delivery/Courier:* 400 7th Street SW, Suite 3E–218, Washington, DC 20219.
- *Fax:* (571) 465–4326.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC–2019–0027" in your comment. In general, the OCC will enter all comments received into the docket and publish the comments on the *Regulations.gov* website without change, including any business or personal information provided such as name and address information, email addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- *Viewing Comments Electronically—Regulations.gov Classic or Regulations.gov Beta.*

Regulations.gov Classic: Go to *https://www.regulations.gov/*. Enter "Docket ID OCC–2019–0027" in the Search box and click "Search." Click on "Open Docket Folder" on the right side of the screen. Comments and supporting materials can be viewed and filtered by clicking on "View all documents and comments in this docket" and then using the filtering tools on the left side of the screen. Click on the "Help" tab on the *Regulations.gov* home page to get information on using *Regulations.gov.* The docket may be viewed after the close of the comment period in the same manner as during the comment period.

Regulations.gov Beta: Go to *https://beta.regulations.gov/* or click "Visit New *Regulations.gov* Site" from the *Regulations.gov* Classic homepage. Enter "Docket ID OCC–2019–0027" in the Search Box and click "Search." Click on the "Comments" tab. Comments can be viewed and filtered by clicking on the "Sort By" drop-down on the right side of the screen or the "Refine Results" options on the left side of the screen. Supporting materials can be viewed by clicking on the "Documents" tab and filtered by clicking on the "Sort By" drop-down on the right side of the screen or the "Refine Results" options on the left side of the screen. For assistance with the *Regulations.gov* Beta site, please call (877) 378–5457 (toll free) or (703) 454–9859 Monday–Friday, 9 a.m.–5 p.m. ET or email *regulations@erulemakinghelpdesk.com.* The docket may be viewed after the close of the comment period in the same manner as during the comment period.

- *Viewing Comments Personally:* You may personally inspect comments at the OCC, 400 7th Street SW, Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649–6700 or, for persons who are deaf or hearing impaired, TTY, (202) 649–5597. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect comments.

FOR FURTHER INFORMATION CONTACT: Andra Shuster, Senior Counsel, Karen

McSweeney, Special Counsel, or Priscilla Benner, Attorney, Chief Counsel's Office, (202) 649–5490, for persons who are deaf or hearing impaired, TTY, (202) 649–5597, Office of the Comptroller of the Currency, 400 7th Street SW, Washington, DC 20219.

SUPPLEMENTARY INFORMATION:

I. Background

Federal law authorizes national banks and savings associations (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. Pursuant to Federal law, national banks and Federal savings associations may also enter into contracts. Inherent in this authority is the authority to assign such contracts. In addition, well-established authority authorizes banks to sell, assign, or otherwise transfer their loans.

Despite these clear authorities, recent developments have created uncertainty about the ongoing validity of the interest term after a bank sells, assigns, or otherwise transfers a loan. After considering the principles discussed below, the OCC has concluded that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer. This proposed rule would codify this conclusion.

II. Analysis

Various provisions of Federal banking law, taken together, show that Congress created an integrated Federal scheme that permits national banks and Federal savings associations to operate across state lines without being hindered by differing state laws. *See, e.g.,* 12 U.S.C. 24, 85, 86, 371, and 1461 *et seq.* The National Bank Act (NBA) provides for a system of national banks to serve as "instrumentalities of the federal government,"[1] which are "designed to be used to aid the government in the administration of an important branch of the public service."[2] The NBA contemplates that national banks will operate nationwide, and accordingly, it provides national banks "protection from 'possible unfriendly State legislation.'"[3] Similarly, through the Home Owners' Loan Act (HOLA), "Congress delegated to the [Federal Home Loan Bank Board (FHLBB)] broad authority to establish and regulate 'a uniform system of [savings and loan] institutions where there are not any now,' and to 'establish them with the force of the government behind them, with a national charter.'"[4]

To carry out Congress's purposes, the NBA vests in national banks enumerated powers and "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. 24(Seventh). HOLA provides Federal savings associations with broad authority to engage in banking activities. 12 U.S.C. 1464. These statutes grant national banks and Federal savings associations the power to make contracts, 12 U.S.C. 24(Third) and 1464,[5] and the power to lend money. 12 U.S.C. 24(Seventh) and 1464.

While not expressly stated in these statutes, among the essential rights normally associated with the power to contract is the ability to subsequently assign some or all of the benefits of a contract to a third party.[6] Restatement (Second) of Contracts § 317 (1981). Generally, all contract rights may be assigned in the absence of clear language expressly prohibiting the assignment or if the assignment would "[(1)] materially change the duty of the obligor or [(2)] materially increase the obligor's burden or risk under the contract or [(3)] the contract involves obligations of a personal nature." 29 Williston on Contracts § 74:10 (4th ed.) (citations omitted). *But see* 29 Williston on Contracts § 74:23 (stating that certain assignments may be specifically forbidden by statute or may otherwise be void as against public policy). All ordinary business contracts are assignable, and a contract for money to become due in the future is among the types of contracts that normally may be assigned.[7] Upon assignment, the third-party assignee steps into the shoes of the bank; the assignee acquires and may enforce the rights the bank assigned to it under the contract.[8]

In the banking context, the authority of banks to sell, assign, or otherwise transfer (assign) a loan is a well-established element of the authority to make loans. Since at least 1848, the Supreme Court has recognized that a bank's authority to assign a loan is a power incident to the authority to make one, even if assignment is not expressly mentioned in the statute.[9] Thus, the Federal statutes that provide national banks and Federal savings associations the authority to make loans also confer upon them the power to assign loans. 12 U.S.C. 24(Seventh), 371, and 1464(c); *see also* 12 CFR 7.4008(a), 34.3, and 160.30.

As part of the authority to lend granted to national banks, Federal law establishes a clear and comprehensive scheme governing the interest that a bank may charge. Twelve U.S.C. 85 provides that a national bank may "charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located."[10] Similarly, 12 U.S.C. 1463(g), which is modeled on and interpreted *in pari materia* with section 85,[11] provides that savings associations may "[n]otwithstanding any State law . . . charge interest . . . at the rate allowed by the laws of the State in which such savings association is located."[12]

The intent of Congress when it originally enacted section 85 in 1864 was to ensure parity between national and state banks in order to allow the new Federal charter to flourish and to establish a uniform national currency.[13] When Congress enacted section 1463(g), it intended to place savings associations on equal footing with their national bank competitors. *See supra* note 11.

[1] *Davis* v. *Elmira Sav. Bank,* 161 U.S. 275, 283 (1896).

[2] *Farmers' & Mechanics' Nat'l Bank* v. *Dearing,* 91 U.S. 29, 33 (1875).

[3] *Beneficial Nat'l Bank* v. *Anderson,* 539 U.S. 1, 10 (2003) (quoting *Tiffany* v. *Nat'l Bank of Mo.,* 85 U.S. 409, 412 (1873)).

[4] *Fid. Fed. Sav. & Loan Ass'n* v. *de la Cuesta,* 458 U.S. 141, 166 (1982) (citations and footnote omitted).

[5] Office of Thrift Supervision (OTS) letter from Carolyn J. Buck, November 22, 1995, 1995 WL 790839.

[6] Rights authorized by a statute need not always be express—they are often implicit in the other rights given by the statute. *See, e.g., Franklin Nat'l Bank* v. *New York,* 347 U.S. 373, 377–78 (1954) (concluding that the right to accept savings deposits implicitly included the right to advertise).

[7] *See Bank of America, N.A.* v. *Rice,* 780 SE2d 873 (N.C. Ct. App. 2015).

[8] *Dean Witter Reynolds Inc.* v. *Var. Annuity Life Ins. Co.,* 373 F.3d 1100, 1110 (10th Cir. 2004) (stating that it was long-established that "an assignee stands in the shoes of the assignor").

[9] *See Planters' Bank of Miss.* v. *Sharp,* 47 U.S. 301, 322–23 (1848); *see also supra* note 6.

[10] Alternatively, section 85 allows a national bank to charge "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." 12 U.S.C. 85. Through interpretive letters, the OCC has addressed where a national bank is located for purposes of section 85. *See, e.g.,* OCC Interpretive Letter 822 (Feb. 17, 1998).

[11] *See Gavey Props./762* v. *First Fin. Sav. & Loan Ass'n,* 845 F.2d 519, 521 (5th Cir. 1988) ("Given the similarity of language, the conclusion is virtually compelled that Congress sought to provide federally insured credit institutions with the same 'most-favored lender' status enjoyed by national banks."); 61 FR 50951, 50968 (Sept. 30, 1996) ("OTS and its predecessor, the FHLBB, have long looked to the OCC regulation and other precedent interpreting the national bank most favored lender provision for guidance in interpreting [12 U.S.C. 1463(g)] and OTS's implementing regulation."); OTS letter from Harris Weinstein, December 24, 1992, 1992 WL 12005275.

[12] Section 1463(g) also allows savings associations to charge an alternate rate that is based on the relevant Federal Reserve discount rate for 90-day commercial paper. *See supra* note 10.

[13] Cong. Globe, 38th Cong., 1st Sess., 2123–27 (1864). *See Roper* v. *Consurve, Inc.,* 578 F.2d 1106 (5th Cir. 1978), *affirmed* 445 U.S. 326 (1980).

Sections 85 and 1463(g) have been interpreted to permit a bank to charge interest at the highest rate allowed to competing lenders by the state where the bank is located (known as the "most favored lender" doctrine) and to export this rate to borrowers in other states, regardless of any other state law purporting to limit the interest permitted on bank loans.[14]

Federal law thus establishes that a bank may enter into a loan contract, charge interest at the maximum rate permitted in the state where it is located, and subsequently assign the loan. These authorities, in turn, provide the fundamental transactional building blocks that are used to construct important portions of the nation's banking system. For example, the ability to originate loans and subsequently securitize them on the secondary market depends upon the ability of banks to assign all or part of their ownership interest in a loan.

Despite the fact that these well-established and heretofore well-understood authorities previously had not been seriously called into question, a recent decision from the United States Court of Appeals for the Second Circuit has created uncertainty regarding the ongoing validity of the interest term determined under section 85 after a national bank assigns a loan.[15] Through this rulemaking, the OCC seeks to end this uncertainty by clarifying that when a bank assigns a loan, interest permissible prior to the assignment will continue to be permissible following the assignment.

Multiple legal principles support the OCC's interpretation. First, well before the passage of the NBA or the HOLA, the Supreme Court recognized the longstanding common law principle of valid-when-made and described it as a "cardinal rule[ ] in the doctrine of usury." [16] The valid-when-made principle provides that if a loan is non-usurious at origination, the loan does not subsequently become usurious when assigned.[17] This longstanding rule relating to usury certainly applies here; a loan by a bank that complies with section 85 or 1463(g) is by definition not usurious when it is originated, and a subsequent assignment of the loan does not render the loan usurious.

Apart from being the natural result if one applies the valid-when-made principle, this conclusion is also supported by banks' ability to assign contracts. As noted above, national banks and Federal savings associations may assign their loan contracts to third parties. Because the assignee steps into the bank's shoes upon assignment, the third party receives the benefit of and may enforce the permissible interest term. Again, the loan does not become usurious after the assignment simply because the third party is enforcing the contractually agreed upon interest term.[18] An assignment does not normally change the borrower's obligation to repay in any material way. *See* 29 Williston on Contracts § 74:10.

Finally, a bank's well-established authority to assign a loan may be unduly curtailed if the bank cannot be certain that interest permissible prior to the assignment will remain permissible afterwards. Congress would not have intended to limit banks' authority in this manner.[19] Even in the mid-nineteenth century, banks' ability to assign their loans was recognized as an important tool to manage liquidity and enhance safety and soundness. As the Supreme Court stated, "[banks] must be able to assign or sell [their] notes when necessary and proper, as, for instance, to procure more specie in an emergency, or return an unusual amount of deposits withdrawn, or pay large debts for a banking-house." [20] The Court further observed that while a bank may have other tools to respond to these circumstances, assigning loans may be the "wiser and safer" course of action.[21] Although the banking system has evolved significantly in the 150 years since *Planters' Bank,* 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.

The conclusion that interest permissible prior to the assignment of a loan continues to be permissible following the assignment is also consistent with the purpose of sections 85 and 1463(g)—to facilitate banks' ability to operate across state lines by eliminating the burden of complying with each state's interest laws. This ability to operate on an interstate basis under a uniform set of standards, including with respect to interest, is fundamental to the character of national banks and has been since their inception.[22] Recognizing the value of this uniformity in applicable interest law, Congress extended the principles of section 85 to savings associations, state-chartered insured depository institutions, and insured credit unions in 1980. *See* 12 U.S.C. 1463(g), 1785, and 1831d. Then, in 2010, while carefully examining the application of state law to Federally-chartered banks, Congress expressly preserved national banks' authority under section 85 and thereby reaffirmed the importance of section 85 and similar statutes to the banking system.[23] Reading sections 85 and 1463(g) as applying only to loans that a bank holds on its books would thwart this statutory scheme and would be inconsistent with the valid-when-made and assignability principles discussed above.

Based on the foregoing, the OCC concludes that, as a matter of Federal law, banks may assign their loans without impacting the validity or enforceability of the interest.

III. Summary of the Proposal

The OCC would amend 12 CFR 7.4001 and 12 CFR 160.110 by adding a new paragraph, which would provide that interest on a loan that is permissible under sections 85 and 1463(g)(1), respectively, shall not be affected by the sale, assignment, or other transfer of the loan.[24] This rule would

[14] *See Marquette Nat'l Bank of Minneapolis* v. *First of Omaha Serv. Corp.,* 439 U.S. 299, 310–14 (1978) ("[The bank] cannot be deprived of [its] location merely because it is extending credit to residents of a foreign State.").

[15] *See Madden* v. *Midland Funding, LLC,* 786 F.3d 246 (2nd Cir. 2015).

[16] *See Nichols* v. *Fearson,* 32 U.S. (7 Pet.) 103, 109 (1833).

[17] *See id.* ("[A] contract, which, in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction."); *Gaither* v. *Farmers & Mechs. Bank of Georgetown,* 26 U.S. (1 Pet.) 37, 43 (1828).

[18] *See Olvera* v. *Blitt & Gaines, P.C.,* 431 F.3d 285, 286, 289 (7th Cir. 2005) ("[T]he assignee of a debt . . . is free to charge the same interest rate that the assignor . . . charged the debtor . . . even if the assignee does not have a license that expressly permits the charging of a higher rate.").

[19] *See Franklin,* 347 U.S. at 377–78.

[20] *Planters' Bank of Miss.,* 47 U.S. at 323.

[21] *Id.*

[22] "National banks have been National favorites . . . It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States . . . ." *Tiffany,* 85 U.S. at 413. The NBA "has in view the erection 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." *Easton* v. *Iowa,* 188 U.S. 220, 229 (1903).

[23] Section 1044(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (July 21, 2010).

[24] The Federal Deposit Insurance Corporation (FDIC) is also proposing a similar rule based on 12 U.S.C. 1831d. The FDIC has interpreted this provision to be consistent with section 85

Continued

expressly codify what the OCC and the banking industry have always believed and address recent confusion about the impact of an assignment on the permissible interest. This rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party. The true lender issue, which has been considered by courts recently, is outside the scope of this rulemaking.

IV. Solicitation of Comments

The OCC invites comment on all aspects of this proposal.

V. Regulatory Analyses

Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.*, the OCC may not conduct or sponsor, and respondents are not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OCC has reviewed the notice of proposed rulemaking and determined that it would not introduce any new or revise any existing collection of information pursuant to the PRA. Therefore, no submission will be made to OMB for review.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the Small Business Administration (SBA) for purposes of the RFA to include commercial banks and savings institutions with total assets of $600 million or less and trust companies with total assets of $41.5 million of less) or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. The OCC currently supervises approximately 755 small entities.[25] The ability to sell, assign, or otherwise transfer a loan is important to all banks, so the OCC expects that all of these small entities would be impacted by the rule. However, the rule does not contain any new recordkeeping, reporting, or significant compliance requirements. Therefore, the OCC anticipates that costs, if any, will be *de minimis* and certifies that this rule, if adopted, would not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (UMRA), 2 U.S.C. 1532, requires the OCC to consider whether the proposed rule includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). The proposed rule does not impose new mandates. Therefore, the OCC concludes that implementation of the proposed rule would not result in an expenditure of $100 million (adjusted for inflation) or more annually by state, local, and tribal governments, or by the private sector.

Riegle Community Development and Regulatory Improvement Act

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA), 12 U.S.C. 4802(a), in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, the OCC must 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. In addition, section 302(b) of RCDRIA, 12 U.S.C. 4802(b), requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form. The OCC invites comments that will inform its consideration of RCDRIA.

(including OCC precedent). *See, e.g.*, FDIC General Counsel's Opinion No. 11, Interest Charges by Interstate State Banks, 63 FR 27282 (May 18, 1998).

[25] The OCC bases its estimate of the number of small entities on the SBA's size thresholds for commercial banks and savings institutions, and trust companies, which are $600 million and $41.5 million, respectively. Consistent with the General Principles of Affiliation, 13 CFR 121.103(a), the OCC counts the assets of affiliated financial institutions when determining if the OCC should classify an OCC-supervised institution as a small entity. The OCC uses December 31, 2018, to determine size because a "financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." *See* footnote 8 of the SBA's *Table of Size Standards*

List of Subjects

12 CFR Part 7

National banks, Interest, Usury.

12 CFR Part 160

Savings associations, Interest, Usury.

Office of the Comptroller of the Currency

For the reasons set out in the preamble, the OCC proposes to amend 12 CFR part 7 and part 160 as follows.

PART 7—ACTIVITIES AND OPERATIONS

■ 1. The authority citation for part 7 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 25b, 29, 71, 71a, 92, 92a, 93, 93a, 95(b)(1), 371, 371d, 481, 484, 1463, 1464, 1465, 1818, 1828(m) and 5412(b)(2)(B).

Subpart D—Preemption

■ 2. Section 7.4001 is amended by adding paragraph (e) to read as follows:

§ 7.4001 Charging interest by national banks at rates permitted competing institutions; charging interest to corporate borrowers.

* * * * *

(e) *Transferred loans.* Interest on a loan that is permissible under 12 U.S.C. 85 shall not be affected by the sale, assignment, or other transfer of the loan.

PART 160—LENDING AND INVESTMENT

■ 3. The authority citation for part 160 continues to read as follows:

Authority: 12 U.S.C. 1462a, 1463, 1464, 1467a, 1701j–3, 1828, 3803, 3806, 5412(b)(2)(B); 42 U.S.C. 4106.

■ 4. Section 160.110 is amended by adding paragraph (d) to read as follows:

§ 160.110 Most favored lender usury preemption for all savings associations.

* * * * *

(d) *Transferred loans.* Interest on a loan that is permissible under 12 U.S.C. 1463(g)(1) shall not be affected by the sale, assignment, or other transfer of the loan.

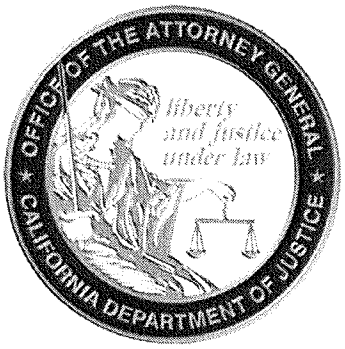
Dated: November 18, 2019.

Morris R. Morgan,

First Deputy Comptroller, Comptroller of the Currency.

[FR Doc. 2019–25280 Filed 11–20–19; 8:45 am]

BILLING CODE 4810–33–P



January 21, 2020

VIA ELECTRONIC SUBMISSION

Joseph M. Otting
Comptroller
Office of the Comptroller of the Currency
Department of Treasury
400 7th Street S.W.
Washington, D.C. 20219

Re: Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred (Docket No. OCC-2019-0027)

Dear Comptroller Otting:

On behalf of the 22 undersigned State Attorneys General and the Hawaii Office of Consumer Protection (the "States"), we write to express our strong and bipartisan objections to a rule proposed by the Office of the Comptroller of the Currency (the "OCC") that would sanction one of the myriad schemes the financial services industry has devised to repackage usury and evasion of state usury laws as "innovations" deserving of special federal protection.[1] At stake are so-called "rent-a-bank" schemes, in which heavily regulated state-chartered banks and national banking and savings associations ("National Banks") enter into relationships with largely unregulated non-bank entities for the sole purpose of allowing non-banks to evade state usury laws. The Proposed Rule would facilitate these arrangements by extending a particular privilege – the right of National Banks to preempt state usury laws – to non-bank entities, notwithstanding the fact that National Banks are afforded this privilege only because they submit to extensive federal oversight and supervision. The OCC would do so despite previously having

[1] *See* O.C.C., *Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*, 84 Fed. Reg. 64,229 (proposed November 21, 2019) (to be codified at 12 C.F.R. § 7.40001 and 12 C.F.R. § 160.110) (the "Proposed Rule"). The Federal Deposit Insurance Corporation (the "FDIC") issued a similar proposal on December 6, 2019. *See* F.D.I.C., *Federal Interest Rate Authority*, 84 Fed. Reg. 66,845 (proposed Dec. 6, 2019) (to be codified at 12 C.F.R. § 331) (the "FDIC Proposed Rule"). The States intend to submit a comment to the FDIC in due course.

condemned these arrangements as "abus[iv]e" and "highly conducive to the creation of safety and soundness problems,"[2] a stark reversal of position the Proposed Rule fails to acknowledge.

As explained in detail below, the OCC has no authority to unilaterally rewrite federal and constitutional law to suit its policy preferences. Unfortunately, that is precisely what the Proposed Rule does.

At a time when Americans of all political backgrounds are demanding that loans with triple digit interest rates be subject to more, not less, regulation,[3] it is disappointing that the OCC instead seeks to expand the availability of exploitative loans that trap borrowers in a never-ending cycle of debt. For the reasons discussed herein, we urge the OCC to withdraw the Proposed Rule in its entirety.

I. Summary of the OCC's Preemption Proposal

The Proposed Rule is purportedly designed to address "uncertainty" created by the 2015 decision of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*.[4] The Proposed Rule would effectively overturn *Madden* and significantly expand National Bank Act, 12 U.S.C. §§ 1 *et seq.* ("NBA") preemption under the pretense of codifying a contract-based principle – the OCC calls it "valid-when-made" – that has nothing to do with NBA preemption and was never mentioned in *Madden*.

Madden concerned a credit card debt originated by a National Bank and subsequently sold to an unaffiliated third-party debt collector. The debt collector sent the plaintiff, a New York resident, a collection notice seeking to recover the debt at an interest rate of 27%, which violates New York's usury cap. The plaintiff sued the debt collector, arguing that its attempt to collect interest that is usurious in New York violated federal and state debt collection statutes. The debt collector argued that, even though it itself was not a National Bank, the plaintiff's claims were preempted by the National Bank Act, 12 U.S.C. §§ 1 *et seq.* ("NBA"), because the debt at issue was originated by a National Bank.[5]

Under the NBA and Supreme Court precedent, National Banks are permitted to charge the maximum interest rate permissible in the state in which they are located, and to "export" that interest rate to borrowers in other states, even if the rate would violate those states' usury laws.[6] As to such loans originated by National Banks, state usury laws are preempted.[7] As the Second

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[2] John D. Hawke, Jr., Comptroller of the Currency, *Remarks Before the Women in Housing and Finance* at 10 (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf. All websites cited in this letter were last visited on January 21, 2020.

[3] For example, when South Dakota voted on an interest rate cap in 2016, the payday loan industry spent over a million dollars lobbying against the measure, which was ultimately approved by 76% of voters in what one opponent of the cap conceded was a "landslide." *See* Bart Pfankuch, *Payday Loans Gone, But Need for Quick Cash Remains*, Capital Journal (Pierre, S.D.), Mar. 23, 2018.

[4] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).

[5] *See id.* at 249.

[6] *See Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003).

[7] The interplay between NBA provisions regarding interest rates and state usury laws is variously described as interest rate exportation or NBA preemption, both of which refer to the same legal issues.

Circuit in *Madden* explained, National Banks are only afforded this privilege because they have submitted to comprehensive regulatory oversight by federal banking regulators.[8] Put differently, the right to export interest rates is conferred upon National Banks *qua* National Banks.

In *Madden*, the Second Circuit acknowledged the limited circumstances under which a National Bank's ability to export its interest rate could be extended to non-bank entities, and set forth the standard to apply in such an inquiry: "To apply NBA preemption to an action taken by a non-national bank entity, application of state law to that action must significantly interfere with a national bank's ability to exercise its power under the NBA."[9] The Second Circuit found that standard unmet because application of usury laws to debts originated by National Banks would not prevent banks from selling debts. At most, it could reduce the price National Banks could charge for such debts,[10] and would in no way impact sales to other National Banks. Moreover, the Court held that extending NBA privileges to unaffiliated assignees of National Banks "would be an overly broad application of the NBA" and would "create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank."[11]

The financial services industry's response to *Madden* was dire. The defendants in *Madden* predicted "catastrophic consequences for secondary markets that are essential to the operations of national banks and the availability of consumer credit,"[12] and a trade group warned that *Madden* "threatens to cause significant harm to [credit] markets, the banking industry, and the millions of families and businesses they serve."[13] Contrary to these predictions, the sky has not fallen in the nearly five years since *Madden* was decided. The OCC testified to Congress in December 2019 that the U.S.'s current economic expansion is "the longest in U.S. history, which has benefited banks' overall financial performance and banks have helped maintain that momentum. *Capital and liquidity remain near historic highs*."[14] The FDIC has similarly stated that it is "not aware of *any* widespread or significant negative effects on credit availability or

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[8] *See Madden*, 786 F.3d at 251 (noting that entities other than National Banks are "neither protected under federal law nor subject to the OCC's exclusive oversight") (internal citation and quotation marks omitted).

[9] *See id.* at 250 (citing *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996)).

[10] *See id.* at 251 ("Here, however, state usury laws would not prevent consumer debt sales by national banks to third parties. Although it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states (i.e., those with firm usury limits, like New York), such an effect would not 'significantly interfere' with the exercise of a national bank power.") (quoting *Barnett Bank*).

[11] *See Madden*, 786 F.3d at 251-52.

[12] *See* Petition for Panel Rehearing and Rehearing En Banc by Defendants-Appellees at 1, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015) (14-CV-2131).

[13] *See* Brief of the Clearing House Association LLC as Amici Curia in Support of Rehearing and Rehearing En Banc at 1, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015) (14-CV-2131).

[14] *See Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions: Hearing Before the H. Comm. on Fin. Servs.*, 116 Cong. 3 (2019) (statement of Joseph M. Otting, Comptroller of the Currency) (emphasis added), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-ottingj-20191204.pdf.

securitization markets having occurred to this point as a result of the *Madden* decision."[15] And *Madden* certainly does not appear to be affecting the profitability of credit card lending by National Banks which, according to a recent headline in the *Washington Post*, "reported blockbuster 2019 profit with the help of consumers' credit card debt."[16]

The OCC apparently disagrees with *Madden*, but one would be hard-pressed to understand why from the Proposed Rule, which engages the merits of the decision only obliquely. Instead, the Proposed Rule focuses on what the OCC describes as "valid-when-made," a general "principle" about the assignability of contracts.[17] The Proposed Rule's reliance on this "principle" is misplaced. The Proposed Rule proceeds from the flawed assumption that NBA preemption is a property interest that can be assigned. It is not. The right to interest rate exportation is a status conferred under federal law upon a National Bank that is personal to the National Bank. Indeed, the OCC has previously embraced this position: "Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself."[18]

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[15] *See* FDIC Proposed Rule, 84 Fed. Reg. at 66,850 (emphasis added). The only evidence that *Madden* has in any way impacted lending in the Second Circuit comes from a single academic study, involving only three non-bank lenders, that purported to find a marginal impact on lending. The study was conducted based on a proprietary data set and therefore has never been subjected to any form of review. *See* Colleen Honigsberg, Robert J. Jackson, Jr., & Richard Squire, *What Happens When Loans Become Legally Void? Evidence from a Natural Experiment*, (Dec. 2, 2016), at 4, *available at* https://www-cdn.law.stanford.edu/wp-content/uploads/2016/12/Honigsberg-et-al-2016-What-Happens-when-Loans-Become-Legally-Void.pdf (noting that the study is based on a "private dataset . . . which contains additional loans, as well as additional detail on loans and borrowers, not included in public databases"); *id.* at p. 15 (stating that the three non-bank lenders provided data to the authors under a non-disclosure agreement).

[16] *See* Renae Merle, *Banks Reported Blockbuster 2019 Profit With the Help of Consumers' Credit Card Debt*, Wash. Post, Jan. 15, 2020, *available at* https://www.washingtonpost.com/business/2020/01/15/banks-reported-blockbuster-2019-profit-with-help-consumers-credit-card-debt/. The article notes that interest rates on credit cards are at near record highs despite several interest-rate cuts by the Federal Reserve.

[17] While the OCC characterizes valid-when-made as a "longstanding common law principle," there is reason to doubt its historical pedigree. *See* Brief of Professor Adam J. Levitin as Amicus Curiae in Support of Plaintiff at 26, *Rent-Rite Super Kegs W., Ltd. v. World Business Lenders, LLC* (D. Colo.) (19-CV-01552-REB) ("If the 'valid-when-made' doctrine were a 'cardinal rule' of banking law, founded on Supreme Court opinions, one would expect it to regularly appear in 19th and 20th century usury and banking law treatises. Yet the doctrine is entirely unknown to historical treatise writers. Nothing even approaching the 'valid-when-made' doctrine in which the assignment of a loan from an originator to an assignee subject to a different state usury law appears in any 19th or 20th century usury treatise. No prior reference to 'valid-when-made' can be found in *any* banking or usury treatise."). Indeed, the Second Circuit did not mention "valid-when-made" in *Madden*, perhaps because none of the parties' briefs did. As of the date of this letter, no reported federal cases use the phrase "valid-when-made principle." The first federal court opinions to use the terms "valid-when-made doctrine" or "valid-when-made rule" post-date *Madden* by more than two years and arise from just two cases, both in the District of Colorado. *Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134, 1152 (D. Colo. 2018); *In re Rent-Rite Superkegs W., Ltd.*, 603 B.R. 41, 66 (Bankr. D. Colo. 2019).

[18] John D. Hawke, Jr., Comptroller of the Currency, *Remarks Before the Women in Housing and Finance* at 10 (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

Because this preemptive status is not conferred *under a contract* – but rather under federal law – valid-when-made or any doctrine concerning the assignability of rights under contract are irrelevant. Nowhere in the Proposed Rule does the OCC explain this reversal, cite any case holding that a personal status conferred by federal law is assignable, or explain how a principle of contract law could override federal law.

Most concerning from the States' perspective, the Proposed Rule does not address the Second Circuit's policy-based concern that extending the NBA to entities other than National Banks would place them outside the reach of any regulator. Consumer protection has historically been among the police powers exercised by the States, and the vast majority of States – including most of the signatories to this letter – rely on usury caps to prevent consumer harm from the abuses endemic to unaffordable, high-cost loans.[19] And while the OCC claims the Proposed Rule is not intended to "address" rent-a-bank schemes,[20] the Proposed Rule purports to preempt state law and exempt from state usury limits *any* entity that happens to acquire debt originated by a National Bank. This is the essence of all rent-a-bank schemes.[21]

Notably, the Proposed Rule conspicuously avoids the word "preemption" to describe its intended effect, but preemption – the displacement by federal law of otherwise applicable state laws or regulations – is transparently what the OCC seeks to accomplish.[22] Any doubt as to whether preemption is the ultimate goal of the Proposed Rule is conclusively answered by titles the agency has given to the regulations it plans to amend: One amendment is titled "Preemption" and the other is titled "Most favored lender usury preemption for all savings associations."[23] Despite the Proposed Rule's emphasis on the valid-when-made doctrine and silence on preemption, as the Supreme Court has held in a related context, if an OCC regulation entitled, "Preemption" "is not pre-emption, nothing is."[24]

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[19] Those states without usury caps have an interest in retaining the ability to impose caps in the future should the need arise.

[20] *See* Proposed Rule at 64,232 ("This rule would not address which entity is the true lender when a bank makes a loan and assigns it to a third party. The true lender issue, which has been considered by courts recently, is outside the scope of this rulemaking.").

[21] Indeed, at least three California non-bank lenders have publicly announced their plans to evade that state's interest rate caps through rent-a-bank schemes. *See* Hannah Wiley, *California Made Triple-Digit Interest Illegal on These Loans. Lenders Have Found a Loophole*, The Sacramento Bee, Dec. 18, 2019, *available at* https://www.sacbee.com/news/politics-government/capitol-alert/article238501288.html#storylink=cpy. Following California's passage of stricter lending rules, Elevate Credit, Enova International, and Curo Group Holdings all told investors that they were working to evade the new law through partnerships with out-of-state banks – precisely the behavior the OCC's Proposed Rule would facilitate. *See id.*

[22] Although the Supreme Court has "used different labels to describe the different ways in which federal statutes may displace state law," all describe varieties of "preemption." *Va. Uranium, Inc. v. Warren*, 139 S. Ct. 1894, 1901 (2019); *accord Murphy v. Nat'l Collegiate Athletic Ass'n*, 138 S. Ct. 1461, 1480 (2018); *see also* PREEMPTION, Black's Law Dictionary (11th ed. 2019) ("5. . . . The principle (derived from the Supremacy Clause) that a federal law can supersede or supplant any inconsistent state law or regulation").

[23] *See* Proposed Rule at 64,232.

[24] *Cuomo v. Clearing House Ass'n, L.L.C.*, 557 U.S. 519, 535 (2009).

II. The OCC's Proposed Rule Is Contrary to Law and Does Not Conform to Requirements Imposed by the Dodd-Frank Act

The Proposed Rule's attempt to exempt from state laws assignees that the OCC does not license or regulate, conflicts with the statutory scheme Congress enacted in the NBA, flouts procedural and substantive requirements imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act") and, ultimately, is beyond the agency's authority to grant.

A. The Proposed Rule Exceeds the OCC's Authority and Is Contrary to the Statutory Scheme Set Forth by Congress

Courts have consistently held the rulemaking authority of federal agencies is constrained by the statutory language Congress chose to enact. "An agency's 'power to promulgate legislative regulations is limited to the authority delegated' to it by Congress."[25] When "Congress has explicitly left a gap for the agency to fill, . . . the agency [may] elucidate a specific provision of the statute by regulation."[26]

By contrast, an agency has no authority to alter the regulatory landscape if "Congress has supplied a clear and unambiguous answer to the interpretive question at hand."[27] "If the intent of Congress is clear, that is the end of the matter; for [any reviewing] court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[28] As the Supreme Court has affirmed, it is a "core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[29] This is especially true for the OCC, whose preemption determinations are entitled only to *Skidmore* deference.[30]

1. The Proposed Rule Conflicts with the Plain Text of NBA Sections 85 and 1463(g)

The primary statutory provisions in the NBA the OCC purports to interpret – 12 U.S.C. sections 85 and 1463(g)(1) – are clear and unambiguous. Section 85 provides, "Any association [*i.e.*, any National Bank] may take receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located[.]" Section 1463(g)(1) similarly states, "Notwithstanding any State law, a savings association may charge interest on any extension of credit . . . at the rate allowed by the laws of the State in which such savings association is located[.]" Thus, sections 85 and 1463 permit National Banks to charge interest in excess of rates permitted by states where they do business if those states impose usury caps

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[25] *Amalgamated Transit Union v. Skinner*, 894 F.2d 1362, 1368 (D.C. Cir. 1990) (quoting *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988)).

[26] *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984).

[27] *Pereira v. Sessions*, 138 S. Ct. 2105, 2113 (2018).

[28] *Id.* (quoting *Chevron*, 467 U.S. at 842-43).

[29] *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 328 (2014).

[30] *See Lusnak v. Bank of Am., N.A.*, 883 F.3d 1185, 1191–92 (9th Cir.), *cert. denied*, 139 S. Ct. 567 (2018) ("[The Dodd-Frank Act] clarified that the OCC's preemption determinations are entitled only to *Skidmore* deference... [under which] an agency's views are 'entitled to respect' only to the extent that they have the 'power to persuade.'") (citing 12 U.S.C. § 25b(b)(5)(A) and quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).

lower than what state law provides where the National Bank is "located." These statutes grant explicit rights to National Banks – and no one else. Sections 85 and 1463(g)(1) say nothing about interest chargeable by assignees, transferees, or purchasers of bank loans. These provisions on their face preempt state law *only* with respect to National Banks.[31] The OCC's Proposed Rule would alter these statutory provisions, even though the OCC nowhere points out any "ambiguity" or "statutory gap" in this straightforward text.[32]

Nevertheless, the OCC's Proposed Rule would cloak non-banks in section 85's preemptive power. The proposed regulations would provide, "Interest on a loan that is permissible under 12 U.S.C. 85 [*sic*] shall not be affected by the sale, assignment, or other transfer of the loan."[33] The OCC's language with respect to § 1463(g)(1) is of a piece: "Interest on a loan that is permissible under 12 U.S.C. 1463(g)(1) [*sic*] shall not be affected by the sale, assignment, or other transfer of the loan."[34]

The agency's use of passive voice obscures what the Proposed Rule would do – expand sections 85 & 1463(g)(1)'s preemptive effect to cover non-bank purchasers of loans and effectively amend the federal code to read "Any association [*or the buyer, assignee, or transferee of any loan made by any association*] may take receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the States, Territory, or District where the bank is located[.]"[35] But this is beyond the agency's power. The OCC simply "may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[36]

2. <u>The Proposed Rule Conflicts with the OCC's Own Longstanding Interpretation and the Intent of Congress</u>

Until now, the OCC has held that the preemptive power of sections 85 and 1463(g) accrue only to National Banks, and that extending such power to non-banks would raise safety and soundness concerns. As the OCC explained in 2002,

> The benefit that national banks enjoy by reason of [state-law preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.
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> We have recently seen several instances in which nonbank lenders who would otherwise have been fully subject to various state regulatory laws have sought to rent out the preemption privileges of a national bank to evade such laws. Indeed, the payday lending

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[31] Similarly, not-for-profit credit unions are exempt from federal income taxation by 26 U.S.C. § 501(c)(14)(A), but that does not mean interest income from loans originated by credit unions remains non-taxable if those loans are sold to a for-profit business. Put differently, credit unions are tax exempt, but when they sell loans, there is no reason to believe that tax-exempt status travels with the loans.

[32] *See Chevron*, 467 U.S. at 843-44.

[33] *See* Proposed Rule at 64,232 (proposed language for 12 C.F.R. § 7.4001(e)).

[34] See *id.* (proposed language for 12 C.F.R. § 160.110)(d)).

[35] 12 U.S.C. § 85 (text in italics supplied); *accord* 12 U.S.C. § 1463(g)(1).

[36] *Util. Air Regulatory Grp.*, 573 U.S. at 328.

> industry has expressly promoted such a "national bank strategy" as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempt to clothe itself with the status of an "agent" of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank.
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> Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender.[37]

More recently, the OCC confirmed in a May 23, 2018 Bulletin that it "views unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)."[38]

Recent legislative (in)activity confirms the straightforward reading that sections 85 and 1463(g) apply to National Banks only. Had Congress meant to exempt non-bank debt buyers from state usury law to the same extent as National Banks, it could have done so. But as recently as 2018, it *declined to do just that*. The Protecting Consumers' Access to Credit Act of 2017 would have exempted loan assignees from state usury laws to the same extent as the National Banks that originated the loans, using language very similar to that contained in the OCC's Proposed Rule.[39] Following the House's passage of the proposed legislation, the Senate took no action, allowing it to expire at the close of the 115th Congress.[40] Congress's consideration and rejection of the policy the OCC now proposes indicates that neither current law nor the will of Congress support the proposal.

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[37] John D. Hawke, Jr., Comptroller of the Currency, *Remarks Before the Women in Housing and Finance* at 10 (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf. Courts have also rejected arrangements between National Banks and non-banks – like those criticized by the OCC – because National Banks that do not bear the predominant economic interest in their loans are not the lender of the loans for preemption purposes. *See, e.g., Cmty. State Bank v. Strong*, 651 F.3d 1241, 1259-60 (11th Cir. 2011) (holding that preemption under the Depository Institution Deregulation and Monetary Control Act – which contains the same language as Section 85 of the NBA – does not apply to a National Bank "if it is not the true lender of the loan"); *Pennsylvania v. Think Fin., Inc.*, No. 14-CV-7139, 2016 WL 183289, at *13 (E.D. Pa. Jan. 14, 2016) (same).

[38] OCC Bulletin 2018-14, *Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending* (May 23, 2018), *available at* https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html.

[39] *See* H.R. 3299, 115th Cong. (2017-2018), *available at* https://www.congress.gov/bill/115th-congress/house-bill/3299/text (proposing to amend 12 U.S.C. §§ 85 and 1463(g) to provide that loans made by National Banks at interest rates in excess of state usury caps applicable to assignees of those loans "shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any State law to the contrary")

[40] *See* S. 1642, 115th Cong. (2017-2018), *available at* https://www.congress.gov/bill/115th-congress/senate-bill/1642/actions?q=%7B%22search%22%3A%5B%22S1642%22%5D%7D&r=2&s=1 (only recorded Senate action on bill is introduction on July 27, 2017).

3. The Proposed Rule Conflicts with Other Elements of the Statutory Scheme Governing National Banks

In construing the statutes it administers, the OCC may not cherry pick the provisions it likes and discard the others. An agency's "reasonable statutory interpretation must account for both 'the specific context in which . . . language is used' and 'the broader context of the statute as a whole.'"[41] The OCC's attempt to extend preemption to entities other than National Banks directly conflicts with the Dodd-Frank Act.

At several points in the Dodd-Frank Act, Congress made clear that the benefits of federal preemption provided by the NBA accrue *only* to National Banks.[42] In provisions codified at 12 U.S.C. § 25b Congress stated – in three separate subsections – that the NBA, which includes section 85, does "not preempt, annul, or affect the applicability of any State law to any subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank)."[43] Thus, by Congress's explicit command, subsidiaries and affiliates of National Banks cannot benefit from section 85's preemption of state usury caps. The Proposed Rule entirely fails to consider or account for this important limitation.

Another provision of section 25b further shows the Proposed Rule is at odds with the NBA as a whole. Section 25b(f) provides that certain NBA amendments in the Dodd-Frank Act do not alter "the authority conferred by section 85 of this title for the charging of interest *by a national bank* at the rate allowed by the laws of the State, territory, or district where the bank is located[.]"[44] While subsection 25b(f) clarifies that Dodd-Frank did not revoke National Banks' exemption from state usury laws, its language reiterates section 85's scope: It applies only to "the charging of interest by a national bank," not third-party assignees.

4. Additional Statutory Provisions Cited by the OCC Lend No Support

The OCC cites several other statutory provisions to buttress the Proposed Rule, but none overcome Congress's clear and unambiguous statements limiting the benefits of sections 85 and 1463(g) to National Banks. "Invoking some brooding federal interest or appealing to a judicial policy preference" is not enough to displace state law; rather, one "must point specifically to 'a constitutional text or a federal statute' that does the displacing or conflicts with state law."[45] But the Proposed Rule does little more than gesture toward National Banks'

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[41] *Util. Air Regulatory Grp.*, 573 U.S. at 321 (quoting *Robinson v. Shell Oil Co.,* 519 U.S. 337, 341 (1997)).

[42] *See* Dodd-Frank Act (amending 12 U.S.C. §§ 25b (b)(2), (e), & (h)(2)). Subsequent references to the Dodd-Frank Act in this letter cite to the amended U.S. Code sections directly.

[43] *See, e.g.*, 12 U.S.C. § 25b(b)(2); *accord id.* § 12b(e) & (h)(2). Congress also provided for equal treatment of preemptive privileges enjoyed by savings associations. *See* 12 U.S.C. § 1465(a) ("Any determination ... regarding the relation of State law to a provision of this chapter or any regulation or order prescribed under this chapter shall be made in accordance with the laws and legal standards applicable to national banks regarding the preemption of State law.")

[44] 12 U.S.C. § 25b(f) (emphasis added).

[45] *Va. Uranium*, 139 S. Ct. at 1901 (quoting *P.R. Dep't of Consumer Affairs v. ISLA Petroleum Corp.*, 485 U. S. 495, 503 (1988)).

authority to "enter into and assign contracts."[46] That is not enough to justify extending National Banks' preemption privilege to non-National Banks.

For instance, the OCC emphasizes National Banks' power "[t]o make contracts" and "loan[] money" granted in 12 U.S.C. § 24.[47] But the mere ability of National Banks to lend and contract sheds no light on whether the OCC may exempt new classes of entities from compliance with state law.

Similarly, that *National Banks* hold "all such incidental powers as shall be necessary to carry on the business of banking," per section 24(Seventh), does not imply *non-banks* may escape state laws of general applicability.[48] The OCC likewise invokes section 371,[49] which provides that "[a]ny national banking association may make, arrange, purchase or sell" real estate loans,[50] but the agency's proposal extends to all loans, not just those financing real estate transactions. And section 371's authorization for banks never suggests non-bank loan purchasers may evade state law, nor does it indicate the OCC has authority to grant any such a state-law exemption.[51]

The Proposed Rules states that third-party assignees of National Bank loans must be exempt from state usury laws because "among the essential rights normally associated with the power to contract is the ability to subsequently assign some or all of the benefits of a contract to a third party."[52] But, as discussed above, preemption of state law is not a "piece of disposable property" that a bank may contract away – it is a privilege specifically granted to National Banks by sections 85 & 1463(g).[53] Moreover, National Banks' power to assign contractual rights is not impaired by the ordinary principle that their counterparties must comply with state law. As the Second Circuit explained, "[a]lthough it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states," such laws do not significantly interfere with banks' powers.[54] The Proposed Rule also fails to account for the fact that state usury laws have absolutely no impact on a National Bank's ability to sell debts to other National Banks.

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[46] Proposed Rule at 64,229.

[47] *See id.* at 64,229, 64,230; *see also* 12 U.S.C. § 1464 (conferring analogous powers on savings associations).

[48] *See* Proposed Rule at 64,230 (quoting 12 U.S.C. § 24(Seventh)).

[49] *See id.*

[50] 12 U.S.C. § 371.

[51] Analogous powers granted to savings associations in 12 U.S.C. § 1464 likewise fail to support the OCC's claim of authority to exempt from state law entities it does not regulate.

[52] Proposed Rule at 64,230.

[53] OCC News Release 2002-10, *Comptroller Calls Preemption a Major Advantage of National Bank Charter* (Feb. 12, 2002), *available at* https://www.occ.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.

[54] *Madden*, 786 F.3d at 251.

5. The OCC's Proposal Conflicts with Principles of Federalism

Finally, even if the Proposed Rule were a plausible interpretation of the statutory scheme, the proposal would fail for lack of sufficient indication that Congress intended to preempt state law. The Supreme Court has held that, unless Congress has chosen to "occupy the legislative field," agencies must begin with "the assumption that the historic police powers of the States are not to be superseded by [federal law] unless that was the clear and manifest purpose of Congress."[55] The presumption against preemption "applies with particular force when Congress has legislated in a field traditionally occupied by the States. . . . Thus, when the text of a preemption clause is susceptible of more than one plausible reading, courts ordinarily accept the reading that disfavors preemption."[56]

Congress has specifically affirmed that the powers granted to National Banks "do[] *not* occupy the field in any area of State law."[57] And there is no question that consumer protection laws, like usury caps, are among those historic police powers held by the States.[58] Accordingly, the strong presumption against preemption applies to the Proposed Rule. Even if the agency's interpretation of sections 85 & 1463(g) were among several reasonable readings, that interpretation must yield to the reasonable non-preemptive interpretation the OCC has previously embraced.[59]

B. The OCC Has Failed to Comply with Procedural and Substantive Requirements Imposed by the Dodd-Frank Act

In the Dodd-Frank Act, Congress imposed new substantive and procedural requirements that the OCC must observe when it seeks to preempt any "State consumer financial law,"[60] like a state usury cap.[61] The Proposed Rule does not even mention these requirements, let alone how the OCC plans to fulfill them.

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[55] *Altria Grp., Inc. v. Good*, 555 U.S. 70, 76-77 (2008) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

[56] *Id.* (internal citations and quotation marks omitted).

[57] 12 U.S.C. § 25b(b)(4) (emphasis added); *accord* 12 U.S.C. § 1465(b).

[58] *Cf. Altria Grp.,* 555 U.S. at 76–77 (holding that federal tobacco regulations did not preempt state consumer protection law).

[59] *Id.*

[60] *See* 12 U.S.C. § 25b(b) (imposing procedural and substantive requirements on OCC's preemption of state consumer financial law); *see also id.* § 1465(a) (requiring the OCC to make any preemption determination relating to savings associations "in accordance with the laws and legal standards applicable to national banks regarding the preemption of State law," *i.e.*, those imposed by section 25b).

[61] "The term 'State consumer financial law' means a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer." 12 U.S.C. § 25b(a)(2). State usury caps regulate the terms and conditions of financial transactions with respect to consumers by limiting the rates of interest that may be charged, *see, e.g.*, Cal. Fin. Code §§ 22303, 22304.5 (regulated maximum rates chargeable in California for certain consumer loans), and thus fit squarely in § 25b's definition of "State consumer financial law."

In section 25b, Congress imposed the following limitations on OCC preemption determinations:

- Before making a preemption determination, the OCC "shall first consult with the Bureau of Consumer Financial Protection and shall take the views of the Bureau into account"[62];
- The OCC shall make such determinations on a "case-by-case basis" in which the Comptroller must determine "the impact of a particular State consumer financial law on [a] national bank that is subject to that law"[63];
- The NBA preempts State consumer financial laws *only* when the state law "prevents or significantly interferes with the exercise by the national bank of its powers" as described by the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996)[64]; and
- "'[T]he OCC may not deem preempted a provision of a state consumer financial law 'unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with [*Barnett Bank*].'"[65]

The agency has failed to abide by these procedural and substantive requirements.[66]

Procedurally, the Proposed Rule ignores the consultation requirement, never mentioning whether the agency has completed or plans to complete the required consultation with the Consumer Financial Protection Bureau.

The Proposed Rule likewise shows no signs of the required "case-by-case" consideration of a state law's impact on a National Bank.[67] It never describes the OCC's consideration of the impact a particular state's usury cap may have on a National Bank. The closest it comes is to describe the OCC's hypothetical concern that "a bank's . . . authority to assign a loan may be unduly curtailed" if state usury laws bind the intended assignee.[68] Notably, the Proposed Rule

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[62] *Id.* § 25b(b)(3)(B).

[63] *Id.* § 25b(b)(1)(B) & (3)(A).

[64] *Id.* § 25b(b)(1)(B); *see also Lusnak*, 883 F.3d at 1191-92.

[65] *Lusnak*, 883 F.3d at 1194 (quoting 12 U.S.C. § 25b(c)).

[66] Section 25b(f) provides that "[n]o provision of title 62 of the Revised Statutes shall be construed as altering or otherwise affecting the authority conferred by section 85 . . . for the charging of interest by a national bank at the rate allowed by the laws of the State . . . where the bank is located[.]" This carve-out does not apply to the present rulemaking. As discussed above, the OCC's proposal is not a product of "authority conferred by section 85." Section 85 permits only National Banks to charge interest in excess of state-law caps otherwise applicable in states where they do business, and section 25b(f)'s preservation of authority drives home that key point: It too notes *only* "the charging of interest *by a national bank*." Moreover, the OCC's proposal relies on a number of authorities *not* granted by section 85. *See, e.g.*, Proposed Rule at 64,230 (citing 12 U.S.C. §§ 24, 371, 1464). Accordingly, section 25b(f)'s limited exemption for "authority conferred by section 85" is inapplicable.

[67] 12 U.S.C. § 25b(3).

[68] Proposed Rule at 64,231.

does not explain the provenance or relevance of this "unduly curtailed" standard, or address the fact that National Banks can sell debts to other National Banks.

Even if the "authority to assign a loan" could be "unduly curtailed" by usury laws applicable to the assignee, whether the OCC's hypothetical[69] is borne out would necessarily depend on the specifics of the state usury cap at issue—*e.g.*, what rates are permissible? which entities are subject to the cap? The answers to these questions will change whether and how a state usury cap will affect the assignees of loans issued by National Banks. That is why § 25b calls for a "case-by-case" consideration of "the impact of a particular State consumer financial law."[70] But the Proposed Rule fails to specify a *single* state usury regime the agency considered, and the OCC has neglected this important procedural requirement.

Substantively, the OCC may not preempt state law without a finding that "the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers," and that finding must be supported "by substantial evidence, made on the record[.]"[71] The OCC has not met these substantive bars either, and its Proposed Rule indicates no intention to do so.

Rather than ground its proposal in identifiable and significant interference with National Bank powers, the OCC speculates that the *Madden* decision has caused "uncertainty" in same secondary credit markets.[72] That is not enough to sustain the agency's proposal.[73] "As Congress provided in Dodd–Frank, the operative question is whether [state consumer protection law] *prevents* [a bank] from exercising its national bank powers or *significantly interferes* with [its] ability to do so. Minor interference with federal objectives is not enough."[74] The OCC appears to take the position that a state law that impacts or inconveniences a National Bank in any way is preempted, but that is not the standard set forth by the Dodd-Frank Act.

Moreover, the OCC has indicated no plan to adduce and evaluate the "substantial evidence, made on the record" that is required to preempt state law.[75] In fact, it has not identified *any* evidence that a particular state usury law as applied to non-banks prevents or

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[69] As noted above, this conjecture itself is dubious because state "usury laws might decrease the amount a national bank could charge for its consumer debt in certain states," but a mere discount on the sale of debt would not amount to significant interference with the power to assign. *Madden*, 786 F.3d at 251.

[70] 12 U.S.C. § 25b(b)(3).

[71] *Id.* § 25b(b)(1)(B) & (c).

[72] Proposed Rule at 64,231 ("[A] recent decision from the United States Court of Appeals for the Second Circuit has created uncertainty regarding the ongoing validity of the interest term determined under section 85 after a national bank assigns a loan.").

[73] In fact, the Court in *Madden* left *no ambiguity* as to its understanding of NBA preemption and its proper application: "No other mechanism appears on these facts by which applying state usury laws to the third-party debt buyers would significantly interfere with either national bank's ability to exercise its powers under the NBA. Rather, such application would limit [ ] only activities of the third party which are otherwise subject to state control, and which are not protected by federal banking law or subject to OCC oversight." *Madden*, 786 F.3d at 251 (internal citations and quotation marks omitted).

[74] *Lusnak*, 883 F.3d at 1194 (emphasis in original) (internal citation omitted).

[75] 12 U.S.C. § 25b(c).

significantly interferes with a National Bank's exercise of its powers. And tellingly, the FDIC's parallel proposal notes there is no such evidence: "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."[76]

Like all federal agencies, the OCC is bound to act in accordance with the procedural and substantive requirements Congress has set forth. It has not done so.

III. The Proposed Rule Violates the Administrative Procedure Act

The Proposed Rule is not only contrary to Congress' statutory scheme set forth in the NBA and the Dodd-Frank Act, it also violates the Administrative Procedure Act, 5 U.S.C. §§ 550 *et seq.* (the "APA"), in multiple ways. The APA requires "reasoned decision making," wherein the grounds for agency action must be "logical and rational."[77] The APA embodies a "basic presumption of judicial review," through which reviewing courts set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[78] The OCC's attempt to regulate non-National Bank entities is in excess of its statutory authority, and its proposal to allow non-National Bank entities to charge interest in excess of state usury laws is arbitrary and capricious, all in violation of the APA.

A. The Lack of Statutory Authority for the Proposed Rule Renders It Unlawful Under the APA

The APA provides that an agency action is unlawful when it is undertaken "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right" or "without observance of procedure required by law."[79] As discussed above, the OCC lacks the authority to issue the Proposed Rule under any provision of the NBA, and the OCC has not even attempted to comply with the requirements of the Dodd-Frank Act. The Proposed Rule thus violates Section 706(2)(C) of the APA.[80]

B. The Proposed Rule Is Arbitrary and Capricious

In addition to being unlawful for lacking statutory authority, the OCC's Proposed Rule is arbitrary and capricious because the OCC (1) relies on factors which Congress has not intended it to consider, (2) fails to consider rent-a-bank schemes that the Proposed Rule would facilitate,

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[76] FDIC Proposed Rule, 84 Fed. Reg. at 66,850.

[77] *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998).

[78] *Dep't of Commerce v. New York*, 139 S. Ct. 2551, 2567 (2019) (citing 5 U.S.C. § 706(2)(A)).

[79] 5 U.S.C. § 706(2)(C).

[80] *See Haitian Ctrs. Council, Inc. v. Sale*, 823 F. Supp. 1028, 1047-48 (E.D.N.Y. 1993) (Court held that Sections 207 and 208 of the Refugee Act of 1980 established exclusive mechanisms for determining the definition of "refugee" and restricted the Attorney General's authority to circumvent this system. Haitian refugees were detained and subject to "extra-statutory" screening not contemplated in Section 207 and 208. The Court found that Sections 207 and 208 did not grant the Attorney General authority to conduct these "extra-statutory" screenings, and thus the Government's action violated Section 706(2)(C) of the APA); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125, (2000) ("Regardless of how serious the problem an administrative agency seeks to address, however, it may not exercise its authority 'in a manner that is inconsistent with the administrative structure that Congress enacted into law.'")

and (3) fails to support its proposal with any factual findings, and its conclusion runs *counter* to the evidence before similar agencies, such as the FDIC.[81]

1. Congress Did Not Intend for the OCC to Consider Non-Banks In Any Proposed Rulemaking

The best evidence that Congress did not intend for the OCC to extend NBA preemption to non-National Bank entities is that Congress itself weighed this possibility and declined to allow this conduct, reasonably so. As discussed above, in 2018 Congress declined to enact a law that would accomplish legislatively what the OCC seeks to accomplish administratively. Therefore, Congress has already "directly spoken to the precise question at issue" and rejected attempts to extend NBA preemption to entities other than National Banks.[82] The OCC's disregard of Congress renders the Proposed Rule arbitrary and capricious.[83]

2. The OCC Failed to Consider that Its Proposed Rule Would Facilitate Predatory Rent-A-Bank Schemes

In attempting to justify the need for promulgating the Proposed Rule, the OCC only considers the hypothetical inability of National Banks to *assign* their loans to third parties if said third parties are subject to state usury laws.[84] The OCC posits, without support, that the U.S. credit markets depend on the expansion of NBA preemption to non-banks, but the OCC fails to consider that the primary benefit of this proposed regime will inure to those non-National Bank entities which seek to "rent" (or, in this case, "buy") National Bank status in order to engage in the business of lending in excess of state usury laws.[85] The OCC has not addressed, even summarily, how the Proposed Rule, if adopted, will serve to incentivize and sanction predatory rent-a-bank schemes. This failure to consider the substantial negative consequences this rule would have on consumer financial protection across the country renders the OCC's Proposed Rule arbitrary and capricious.

First, the OCC suggests that "a bank's well-established authority to assign a loan may be unduly curtailed if the bank cannot be certain that interest permissible prior to the assignment will remain permissible afterwards."[86] This proposition is not supported by any consideration of whether loan assignments have *in fact* been curtailed, and if so, to what extent. The OCC's "conclusory statements do not suffice to explain its decision."[87]

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[81] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[82] *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2124-25 (2016).

[83] *See Grace v. Whitaker*, 344 F. Supp. 3d 96, 125 (D.C. Cir. 2018) (INS new rule concerning "credible fear" determinations was arbitrary and capricious because there was no "legal basis for an effective categorical ban on domestic violence and gang-related claims.")

[84] *See* Proposed Rule at 64,230.

[85] "[A]gency action is lawful only if it rests on a consideration of the relevant factors and must be invalidated if the agency entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs.*, 463 U.S. at 43 (internal citations omitted).

[86] Proposed Rule at 64,231.

[87] *Encino Motorcars*, 136 S. Ct. at 2127.

Second, the OCC's failure to consider how the Proposed Rule invites rent-a-bank schemes is arbitrary and capricious considering that the OCC explicitly admits that it is *aware* of the problem. The final sentence of the Summary of the Proposed Rule recognizes the "true lender" issue but inexplicably dismisses the matter as irrelevant to the OCC's current rulemaking.[88] The OCC's tacit admission that the Proposed Rule implicates "true lender" issues indicates a materially critical factor that the OCC must consider. The OCC ignores the consumer harm that is all but sure to ensue if rent-a-bank schemes are allowed and encouraged, and proceeds arbitrarily and capriciously from a one-sided and partial perspective.[89]

3. The OCC Fails to Offer Any Evidence to Support the Dramatic Expansion of NBA Preemption

Finally, the Proposed Rule is arbitrary and capricious because the OCC fails to set forth *any* factual findings or any reasoned analysis supporting its decision to extend NBA preemption to *all* non-bank entities that purchase loans from National Banks. Under the APA, the OCC "must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[90] That requirement is satisfied when the agency's explanation is clear enough that its "path may reasonably be discerned."[91] But where an agency fails to provide a sufficiently minimal level of analysis, its action is arbitrary and capricious and cannot carry the force of law.[92]

The Proposed Rule contains no factual findings. Instead, the OCC presents a doomsday scenario faced by the banking industry presumably caused by the *Madden* decision. The OCC speculates that a National Bank's ability to assign a loan "may be curtailed" if a subsequent purchaser cannot charge the same interest as the National Bank.[93] The OCC also concludes, without support, that a non-National Bank assignee's inability to escape the application of state usury laws somehow would "limit the bank's authority" to assign loans.[94] Then, the OCC further concludes that maintaining permissible interest rates following assignment, regardless of the buyer, is necessary to facilitate a National Bank's ability to operate across state lines.[95] The OCC suggests, without support, that the entire interstate banking industry hinges on non-banks' ability to avoid state usury laws. All of these assertions are both unsupported and *unsupportable*. As discussed above, the OCC testified to Congress last month that credit markets are functioning smoothly; the FDIC acknowledges in its similar proposal that it is "not aware of any widespread

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[88] *See* Proposed Rule at 64,232.

[89] *See Ctr. for Biological Diversity v. Nat'l Highway Traffic Safety Admin.*, 538 F.3d 1172, 1198 (9th Cir. 2008) (agency cannot "put a thumb on the scale" by undervaluing key effects and overvaluing others); *Water Quality Ins. Syndicate v. United States*, 225 F. Supp. 3d 41, 69 (D.D.C. 2016) (invalidating agency decision based on "cherry-pick[ed] evidence"); *accord Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (agency must weigh "the advantages and the disadvantages" of its regulatory decisions).

[90] *Motor Vehicle Mfrs.*, 463 U.S. at 43.

[91] *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974).

[92] *See* 5 U.S.C. § 706(2)(A); *Motor Vehicle Mfrs.*, 463 U.S. at 42-43; *Encino Motorcars*, 136 S. Ct. at 2125.

[93] *See* Proposed Rule at 64,231.

[94] *Id.*

[95] *Id.*

or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision";[96] and National Banks are reaping record profits from credit card lending. As the Supreme Court has repeatedly affirmed, an agency's failure to include a rational connection between the data and the agency decision is arbitrary and capricious.[97] Here, the OCC has presented no data to support its conjecture and speculation, let alone a *connection* between data and its decision.

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As the very first Comptroller advised in an 1863 letter: "Splendid financiering is not legitimate banking, and splendid financiers in banking are generally either humbugs or rascals."[98] The Proposed Rule would sanction precisely the type of "splendid financiering" condemned by the OCC over one hundred years ago. The OCC should withdraw the Proposed Rule in its entirety.

Respectfully submitted,

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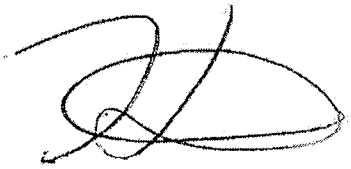

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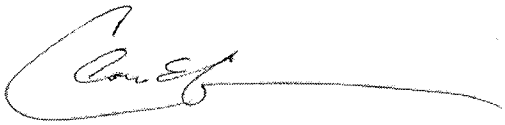

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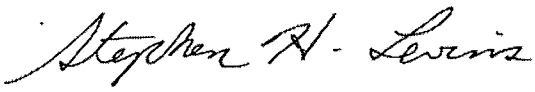

STEPHEN H. LEVINS
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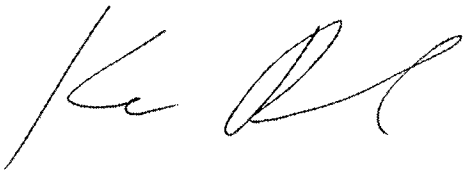

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[96] *See* FDIC Proposed Rule at 66,850.

[97] *Dep't of Commerce*, 139 S. Ct. at 2569.

[98] Hugh McCulloch, Comptroller of the Currency, *Advice to Bankers of 1863* (Dec. 1863) *available at* https://www.occ.treas.gov/about/who-we-are/history/hugh-mcculloch-first-comptroller/comptroller-mccullochs-advice.pdf.

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PRESS RELEASE

Federal Deposit Insurance Corporation

November 19, 2019

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FDIC Proposes New Rule Clarifying Federal Interest Rate Authority

Proposal to address marketplace uncertainty following 2015 court opinion

WASHINGTON – The Federal Deposit Insurance Corporation's Board of Directors is proposing a new rule to clarify the Federal law governing interest rates state banks may charge their customers. The FDIC's proposal is intended to address marketplace uncertainty in the wake of a 2015 court ruling that called into question the enforceability of interest rate terms following the sale or assignment of a loan originated by a national bank to a third-party non-bank.

The FDIC's proposal would codify legal guidance the agency has relied upon for more than 20 years regarding interest rates that may be charged by State-chartered banks and insured branches of foreign banks. The guidance, which is consistent with decades of case law, provides that a permissible interest rate on a loan, as permitted by the law where the bank is located, would not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale/assignment/transfer of the loan. However, in 2015 the U.S. Court of Appeals for the Second Circuit ruled in *Madden v. Midland Funding, LLC* that federal interest rate authority does not apply following the sale or assignment of a loan to a non-bank, which created uncertainty regarding the enforceability of loans originated and sold by State banks.

Although the proposal does not address which entity is the "true lender" when a state bank makes a loan and assigns it to a third party, the proposal states that the FDIC views 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.

The FDIC is soliciting public comment on the proposal, which implements sections 27 and 24(j) of the *Federal Deposit Insurance Act* and seeks to reaffirm and codify this 'valid-when-made' doctrine.

Attachments:
Fact Sheet
FDIC's Notice of Proposed Rulemaking
FDIC Chairman Jelena McWilliams' statement

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Statement by FDIC Chairman Jelena McWilliams

on the

Notice of Proposed Rulemaking: Federal Interest Rate Authority

FDIC Board Meeting
November 19, 2019

The proper functioning of financial markets is paramount to the ability of our financial system to prosper. When markets operate in a fair, equitable, and transparent manner, they allow capital and credit to be allocated efficiently and effectively. When markets are disrupted, it impacts the ability of individuals, financial institutions, and businesses to manage risk—including capital and liquidity risk—and limits the availability of credit necessary to maintain economic growth. As a prudential regulatory matter, market disruptions can pose significant safety and soundness concerns. This proposal seeks to remedy an ongoing market anomaly and also satisfies the goal of codifying longstanding supervisory guidance.

This notice of proposed rulemaking proposes regulations implementing sections 27 and 24(j) of the Federal Deposit Insurance Act (FDI Act). Specifically, it would codify guidance regarding interest rates that may be charged by State-chartered banks and insured branches of foreign banks.

While this guidance has been in effect for over 20 years, recent developments in the courts have challenged longstanding notions of the federal interest rate regime and have called into question longstanding Supreme Court precedents regarding the validity of loans assigned by banks. Specifically, the 2015 decision of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC* called into question the validity and enforceability of the interest rate terms of a loan agreement following the assignment of that loan from a national bank to a non-bank third party. The Court found that the National Bank Act did not permit the assignee of the loan to charge interest at the rate of the original promissory note. This decision deviates from prior interpretations of the National Bank Act, and is contrary to over one-hundred years of Supreme Court precedent regarding sanctity of contracts.

This decision has interjected significant uncertainty to the secondary markets for loan sales in the Second Circuit, which raises safety and soundness concerns for financial institutions that may be unable to sell loans to manage liquidity and capital on their balance sheets. Banks and financial institutions rely on a robust secondary market to manage exposure. For example, banks may need increased liquidity in a time of financial stress or to meet unusual deposit demands, or to make additional credit available in times of increased demand. If the secondary market is not available, it calls into question the value of loans on bank balance sheets, and could lead to significant safety and soundness concerns.

The *Madden* decision was an unnecessary deviation from longstanding notions of contract law and created market instability in the Second Circuit. This proposed rule would correct this anomaly by establishing in regulations implementing section 27 of the FDI Act that the

permissibility of the interest rate would be determined when a loan is made and is not impacted by subsequent assignment, sale, or transfer.

In reaffirming and codifying in regulation the valid-when-made doctrine, the proposal 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." Moreover, the FDIC views unfavorably the arrangements in which an entity partners with a State bank for the sole purpose of evading a lower interest rate established under the law of the entity's licensing state(s).

I support this proposed rule and thank all the staff for the hard work and coordination with the Office of the Comptroller of the Currency to publish this proposed rule.

Thank you.

Proposed Rules

Federal Register
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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 331

RIN 3064–AF21

Federal Interest Rate Authority

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Federal Deposit Insurance Corporation (FDIC) is seeking comment on proposed regulations clarifying the law that governs the interest rates State-chartered banks and insured branches of foreign banks (collectively, State banks) may charge. The proposed regulations would 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 proposed regulations also would provide that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act would be determined at the time the loan is made, and interest on a loan permissible under section 27 would not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

DATES: Comments will be accepted until February 4, 2020.

ADDRESSES: You may submit comments on the notice of proposed rulemaking using any of the following methods:

- *Agency website: https://www.fdic.gov/regulations/laws/federal.* Follow the instructions for submitting comments on the agency website.
- *Email: comments@fdic.gov.* Include RIN 3064–AF21 on the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.
- *Hand Delivery:* Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
- *Public Inspection:* All comments received, including any personal information provided, will be posted generally without change to *https://www.fdic.gov/regulations/laws/federal.*

FOR FURTHER INFORMATION CONTACT: James Watts, Counsel, Legal Division, (202) 898–6678, *jwatts@fdic.gov;* Catherine Topping, Counsel, Legal Division, (202) 898–3975, *ctopping@fdic.gov;* or Romulus Johnson, Counsel, Legal Division, (202) 898–3820, *romjohnson@fdic.gov.*

SUPPLEMENTARY INFORMATION:

I. Policy Objectives

Federal law authorizes State 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, or one percent in excess of the ninety-day commercial paper rate, whichever is greater. A bank's power to make loans implicitly carries with it the power to assign loans, and thus, a State bank's statutory authority to make loans at this rate necessarily includes the power to assign loans at the same rate. The ability of an assignee to enforce a loan's interest-rate terms is also consistent with fundamental principles of contract law.

Despite these clear authorities, recent developments have created uncertainty about the ongoing validity of interest-rate terms after a State bank sells, assigns, or otherwise transfers a loan. The decision of the U.S. Court of Appeals for the Second Circuit in *Madden* v. *Midland Funding, LLC*[1] has called into question the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a non-bank. The 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, regardless of interest rate restrictions by other States—does not apply to non-bank assignees of loans. 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. Therefore, *Madden* also has created uncertainty regarding the enforceability of loans originated and sold by State banks. Moreover, the decision continues to cause ripples with pending litigation challenging longstanding market practices.

Section 27 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831d) provides State banks the authority to charge interest at the rate allowed by the law of the State where the bank is located, or one percent more than the rate on ninety-day commercial paper, whichever is greater. The legal ambiguity generated by *Madden* has led the FDIC to consider issuing regulations implementing the relevant statutory provisions.[2] Uncertainty regarding the enforceability of interest rate terms may hinder or frustrate loan sales, which are crucial to the safety and soundness of State banks' operations for a number of reasons. Loan sales enable State banks to increase their liquidity in a crisis, to meet unusual deposit withdrawal demands, or to pay unexpected debts. Loan sales also enable banks to make additional loans and meet increased credit demand. Banks also may need to sell loans to address excessive concentrations in particular asset classes. In addition, banks may need to sell non-performing loans in circumstances where it would be costly or inconvenient to pursue collection strategies. There may be additional valid business reasons for State banks to sell loans.

Accordingly, the FDIC is proposing regulations that would implement section 27 of the FDI Act. The proposed regulations would implement the statutory provisions that authorize State banks to charge interest of up to the greater of: One percent more than the rate on 90-day commercial paper; or the rate permitted by the State in which the bank is located. The proposed

[1] 786 F.3d 246 (2d. Cir. 2015).

[2] 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*).

regulations also would provide that whether interest on a loan is permissible under section 27 would be determined at the time the loan is made, and would not be affected by subsequent events, such as 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[3] 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 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 supports 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 that would be implemented by the proposed 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 proposed rule would implement the FDI Act, rather than section 85, the following background information is intended to frame the discussion of the proposed 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.[4]

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.[5] 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.[6]

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*,[7] 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.[8]

B. Interest Rate Authority of State Banks

In the late 1970s, monetary policy was geared towards combating inflation and interest rates soared.[9] 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)[10] and granted all federally-insured financial institutions—State banks, savings associations, and credit unions—similar interest rate authority to that provided to national banks.[11] The incorporation was not mere happenstance. Congress made a conscious choice to incorporate section 85's standard.[12] 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.[13]

As stated above, section 27(a) of the FDI Act was patterned after section 85.[14] Because section 27 was patterned after section 85 and uses similar language, courts and the FDIC have consistently

[3] 12 U.S.C. 1831a(j).

[4] 12 U.S.C. 85.

[5] 85 U.S. 409 (1873).

[6] *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).

[7] 439 U.S. 299 (1978).

[8] *See Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

[9] *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).

[10] Public Law 96–221, 94 Stat. 132, 164–168 (1980).

[11] *See* Statement of Senator Bumpers, 126 Cong. Rec. 6,907 (Mar. 27, 1980).

[12] *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).

[13] 12 U.S.C. 1831d(a).

[14] 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, Public Law 96–221.

construed section 27 *in pari materia* with section 85.[15] 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.[16]

Pursuant to section 525 of DIDCMA,[17] 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.[18]

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.[19] 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.[20] The statute also provided for preemption where the Comptroller of the Currency determines that State law discriminates between an interstate national bank and an interstate State bank.[21] 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.[22] 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).[23] 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.[24]

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

The FDIC has not issued regulations implementing sections 24(j) and 27 of the FDI Act, but these provisions 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.[25] [26]

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." [27] 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." [28]

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).[29] 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, disbursal 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

[15] *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).

[16] *Greenwood Trust Co.*, 971 F.2d at 827.

[17] 12 U.S.C. 1831d note.

[18] *See* 1980 Iowa Acts 1156 § 32; P.R. Laws Ann. tit. 10 § 9981. Some other States have previously opted out for a number of years, but either rescinded their respective opt-out statutes or allowed them to expire.

[19] Public Law 103–328, 108 Stat. 2338 (Sept. 29, 1994).

[20] 12 U.S.C. 36(f)(1)(A), reads, in relevant part:

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.

[21] 12 U.S.C. 36(f)(1)(A)(ii).

[22] Public Law 103–328, sec. 102(a).

[23] Public Law 105–24, 111 Stat. 238 (July 3, 1997).

[24] 12 U.S.C. 1831a(j)(1).

[25] FDIC General Counsel's Opinion No. 10, *Interest Charged Under Section 27 of the Federal Deposit Insurance Act*, 63 FR 19258 (Apr. 17, 1998).

[26] 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).

[27] Interpretive Letter No. 822 at 9 (citing statement of Senator Roth).

[28] Interpretive Letter No. 822 at 10.

[29] FDIC General Counsel's Opinion No. 11, *Interest Charges by Interstate State Banks*, 63 FR 27282 (May 18, 1998).

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.

E. Assignees' Right To Enforce Interest Rate Terms

Banks' power to make loans implicitly carries with it the power to assign loans,[30] and 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 an assignee the right to enforce a loan's terms would effectively prohibit assignment and render the power to make the loan at the rate provided by the statute illusory.

The inherent authority of State banks to assign loans that they make is 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." [31] The National Bank Act specifically 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." [32]

The ability of a nonbank assignee to enforce interest-rate terms 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 shoes of the assignor.[33] 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.[34] 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.

Section 27 does not state at what point in time the permissibility of interest should be determined in order to assess whether a State bank is taking or receiving interest in compliance 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. 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, the FDIC concludes that the permissibility of interest under section 27 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. Under the proposed regulation, the permissibility of interest is determined when a loan is made, and is not affected by later events such as a change in State law or the sale, assignment, or other transfer of the loan. The FDIC's interpretation of section 27 is based on the need for a workable rule to determine the timing of compliance with that section. This interpretation is not based on the common law "valid when made" rule, although it is consistent with it. That 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.[35]

The ability of an assignee to rely on the enforceability and collectability in full of a loan that is validly made is also central to the stability and liquidity of the domestic loan markets. Restrictions on assignees' abilities to enforce interest rate terms would result in extremely distressed market values for many loans, frustrating the purpose of the FDI Act.

F. Need for Rulemaking and Rulemaking Authority

The FDIC has previously proposed to issue regulations implementing sections 24(j) and 27 of the FDI Act. In December 2004, a petition for rulemaking was filed with the FDIC seeking the issuance of regulations implementing sections 24(j) and 27 of the FDI Act, codifying the two longstanding opinions of the FDIC's General Counsel discussed above, and clarifying the interest rates that interstate State banks may charge. The petitioners were concerned, in particular, with restoring parity between State banks and national banks following the issuance of regulations by the OCC that preempted certain State laws with respect to national banks.[36]

The FDIC held a public hearing on the petition on May 24, 2005, and a number of interested parties presented their views at the hearing or in writing. Following this hearing, the FDIC issued a notice of proposed rulemaking for regulations that would implement

[30] *See Planters' Bank of Miss.* v. *Sharp,* 47 U.S. 301, 322–23 (1848).

[31] 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. *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").

[32] 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 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.

[33] *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 NW2d 489, 490 (Wis. 1950) (assignee "stands exactly in the shoes of [the] assignor," and "succeeds to all of his rights and privileges").

[34] *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.

[35] 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.").

[36] *See* 70 FR 13413 (Mar. 21, 2005) (notice of hearing and petition).

sections 24(j) and 27, and solicited public comment on this proposal. The FDIC never finalized the proposed rule; however, subsequent changes to the statutory and regulatory framework governing the preemption of State laws may have addressed the petitioners' concerns.[37]

In proposing regulations that would implement sections 24(j) and 27, the FDIC is now seeking to address a different concern. As discussed above, a recent court decision has created uncertainty as to the ability of assignees to enforce interest-rate provisions of loans originated by banks. This court held that, under the facts presented in that case, nonbank debt collectors who purchase debt[38] from national banks are subject to usury laws of the debtor's State[39] and do not benefit from the interest-rate provisions of section 85 because State usury laws do not "significantly interfere with a national bank's ability to exercise its power under the [National Bank Act]."[40] The court's decision created uncertainty and a lack of uniformity in secondary credit markets. While *Madden* interpreted section 85, rather than the FDI Act, section 27 is patterned after section 85 and receives the same interpretation as section 85. Thus, *Madden* also creates uncertainty with respect to State banks' authorities. Through the proposed regulations implementing section 27, the FDIC would reaffirm the enforceability of a loan's interest rate by an assignee of a State bank and reaffirm its position that the preemptive power of section 27 extends to such transactions.

The FDIC also seeks 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.[41] To the extent assignees of national banks' loans may enforce the contractual interest-rate terms of such loans, the FDIC seeks to reaffirm similar authority for State banks' assignees.

Finally, the regulations also 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 FDIC has the authority to issue rules generally to carry out the provisions of the FDI Act.[42] In addition, section 10(g) of the FDI Act, 12 U.S.C. 1820(g), provides the FDIC authority to prescribe regulations carrying out the FDI Act, and to define terms as necessary to carry out the FDI Act, except to the extent such authority is conferred on another Federal banking agency. No other agency has been granted the authority to issue rules to restate, implement, clarify, or otherwise carry out, either section 24(j) or section 27 of the FDI Act.

III. Description of the Proposed Rule

A. Application of Host State Law

Section 331.3 of the proposed 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).[43] Consistent with section 24(j)(1), the proposed 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 proposed 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 ninety-day commercial paper; 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, 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 proposed rule is intended to maintain parity between State banks and national banks, and corresponds with the authority provided

[37] The Dodd-Frank Act amended the National Bank Act by codifying a preemption standard in 12 U.S.C. 25b. In July 2011, the OCC implemented a final rule revising its preemption regulations to incorporate this standard. *See* 12 CFR 7.4007, 7.4008, 34.4. Under this standard, a "state consumer financial law" is generally preempted if it would have a "discriminatory effect" on national banks or in accordance with the legal standard in the Supreme Court's decision in *Barnett Bank.* However, section 25b preserved interest rate preemption.

[38] In *Madden,* the relevant debt was a consumer debt (credit card) account.

[39] 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.

[40] *Madden,* 786 F.3d at 251 (*citing Barnett Bank of Marion City, N.A.* v. *Nelson,* 517 U.S. 25, 33 (1996); *Pac. Capital Bank, N.A.* v. *Connecticut,* 542 F.3d 341, 353 (2d. Cir. 2008)).

[41] *See* Brief for United States as amicus curiae, *Midland Funding, LLC* v. *Madden* (No. 15–610), at 6.

[42] "[T]he Corporation . . . shall have power . . . . To prescribe by its Board of Directors such rules and regulations as it may deem necessary to carry out the provisions of this Act or of any other law which it has the responsibility of administering or enforcing (except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to any other regulatory agency)." 12 U.S.C. 1819(a)(Tenth).

[43] 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).

to national banks under the OCC's regulations at 12 CFR 7.4001(b).

Paragraph (c) of section 331.4 clarifies the effect of the proposed rule's definition of the term *interest* for purposes of State law. Importantly, the proposed rule's definition of *interest* would 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 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. This provision of the proposed rule corresponds to a similar provision in the OCC's regulations, 12 CFR 7.4001(c).

Paragraph (d) of proposed 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 would be 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 CFR 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 the permissibility under section 27 of interest on a loan shall not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan. 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).

IV. Expected Effects

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

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. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected. 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' 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.

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." [44] Such uncertainty has the potential to chill State banks' willingness to make the types of loans affected by the proposed rule. By reducing such uncertainty, the proposed 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 platforms that use a partner bank origination model." [45] 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.[46]

Particularly in jurisdictions affected by *Madden,* to the extent the proposed 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 proposed 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 proposed 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 proposed rule should make State banks' loans more marketable, enhancing State banks' ability to

[44] "*Madden* v. *Midland Funding:* A Sea Change in Secondary Lending Markets," Robert Savoie, McGlinchey Stafford PLLC, p. 3.

[45] Moody's Investors Service, "Uncertainty Lingers as Supreme Court Declines to Hear *Madden* Case" (Jun. 29, 2016).

[46] 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.*

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. Additionally, securitizing or selling loans gives State banks flexibility to comply with risk-based capital requirements.

Similarly, the proposed 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.

Finally, the proposed rule would 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.

V. Request for Comment

The FDIC is inviting comment on all aspects of the proposed rule.

VI. Regulatory Analysis

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires an agency, in connection with a proposed rule, to prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.[47] However, an initial 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.[48] The Small Business Administration (SBA) has defined "small entities" to include banking organizations with total assets of less than or equal to $600 million.[49]

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 impact of the proposed rule on small entities in accordance with the RFA. Based on its analysis and for the reasons stated below, the FDIC believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the FDIC is presenting and inviting comment on this initial regulatory flexibility analysis.

Reasons Why This Action Is Being Considered

The Second Circuit's decision in *Madden* v. *Midland Funding* 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[50] from national banks are subject to usury laws of the debtor's State[51] 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]."[52] 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.F in this **Federal Register** Notice entitled "Need for Rulemaking and Rulemaking Authority."

Objectives and Legal Basis

The policy objective of the proposed 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 objectives and legal basis of the proposed 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 June 30, 2019, there were 4,206 State-chartered FDIC-insured depository institutions, of which 3,171 have been identified as "small entities" in accordance with the RFA.[53] All 3,171 small State-chartered FDIC-insured depository institutions are covered by the proposed rule and therefore, could be affected. However, only 48 small State-chartered FDIC-insured depository institutions 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 institutions 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 FDIC-insured depository institutions 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 FDIC-insured depository institutions, as well as present and future plans to sell or transfer assets. The FDIC does not have this information.

Expected Effects

The proposed 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

[47] 5 U.S.C. 601 *et seq.*

[48] 5 U.S.C. 605(b).

[49] 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.

[50] In *Madden*, the relevant debt was a consumer debt (credit card) account.

[51] 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.

[52] *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).

[53] FDIC Call Report Data, June 30th, 2019.

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.

The FDIC is not aware of any broad effects on credit availability having occurred as a result of *Madden*. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo, broad effects on credit availability are not expected. It is plausible, however, that *Madden* could have discouraged the origination and sale of loan products whose contractual interest rates could potentially exceed State usury limits by small State-chartered institutions in the Second Circuit. The proposed rule could increase the availability of such loans from State banks, but the FDIC believes the number of institutions materially engaged in making loans of this type to be small.

The small State-chartered institutions 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 proposed rule is unlikely to pose any new reporting, recordkeeping, or other compliance requirements for small, FDIC-supervised institutions.

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.

Discussion of Significant Alternatives

The FDIC believes the proposed amendments will not have a significant economic impact on a substantial number of small FDIC-supervised banking entities and therefore believes that there are no significant alternatives to the proposal that would reduce the economic impact on small FDIC-supervised banking entities.

The FDIC invites comments on all aspects of the supporting information provided in this section, and in particular, whether the proposed rule would have any significant effects on small entities that the FDIC has not identified.

B. Riegle Community Development and Regulatory Improvement Act

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.[54] 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.[55]

The proposed rule would not impose additional reporting or disclosure requirements on insured depository institutions, including small depository institutions, or on the customers of depository institutions. Accordingly, section 302 of RCDRIA does not apply. Nevertheless, the requirements of RCDRIA will be considered as part of the overall rulemaking process, and the FDIC invites comments that will further inform its consideration of RCDRIA.

C. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501–3521, 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 proposed rule would not require any information collections for purposes of the PRA, and therefore, no submission to OMB is required.

D. The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999.[56]

E. Plain Language

Section 722 of the Gramm-Leach-Bliley Act[57] requires the Federal banking agencies to use plain language in all proposed and final rulemakings published in the **Federal Register** after January 1, 2000. The FDIC invites your comments on how to make this proposal easier to understand. For example:

- Has the FDIC organized the material to suit your needs? If not, how could the material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be stated more clearly?
- Does the proposed regulation contain language or jargon that is unclear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand?

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 proposes to amend title 12 of the Code of Federal Regulations by adding part 331 to read as follows:

PART 331—FEDERAL 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

[54] 12 U.S.C. 4802(a).

[55] 12 U.S.C. 4802(b).

[56] Public Law 105–277, 112 Stat. 2681.

[57] Public Law 106–102, 113 Stat. 1338, 1471.

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—

Home state means, with respect to a State bank, the State by which the bank is chartered.

Host state means a State, other than the home State of a State bank, in which the State bank maintains a branch.

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

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.

Out-of-state state bank means, with respect to any State, a State bank whose home State is another State.

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.

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 section 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. The permissibility under section 27 of the Federal Deposit Insurance Act of interest on a loan shall not be affected by any subsequent events, including 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.

Federal Deposit Insurance Corporation.

By order of the Board of Directors.

Dated at Washington, DC, on November 19, 2019.

Annmarie H. Boyd,

Assistant Executive Secretary.

[FR Doc. 2019–25689 Filed 12–5–19; 8:45 am]

BILLING CODE 6714–01–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R07–OAR–2019–0662; FRL–10002–66–Region 7]

Air Plan Approval; Missouri; Restriction of Emissions From Batch-Type Charcoal Kilns

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to approve revisions to the Missouri State Implementation Plan (SIP) received on March 7, 2019. The submission revises a Missouri regulation that establishes emission limits for batch-type charcoal kilns based on operational parameters to reduce emissions of particulate matter (PM_{10}), volatile organic compounds (VOCs) and carbon monoxide (CO).

FACT SHEET | Notice of Proposed Rulemaking on Federal Interest Rate Authority

The Federal Deposit Insurance Corporation published a proposed rule to clarify the law governing the interest rates state banks may charge.

ADDRESSES MARKETPLACE UNCERTAINTY: The proposal would address marketplace uncertainty regarding the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a non-bank.

In 2015, the United States Court of Appeals for the Second Circuit issued a decision *(Madden v. Midland Funding, LLC)* that called into question such enforceability by holding that 12 U.S.C. §85 – which authorizes national banks to charge interest at the rate permitted by the law of the state in which the bank is located, regardless of other states' interest rate restrictions – does not apply following assignment of a loan to a non-bank. This decision created legal uncertainty and a lack of uniformity in secondary credit markets.

- Although the decision concerned a loan made by a national bank, the statutory provision governing state banks' authority with respect to interest rates is patterned after and interpreted in the same manner.

- The proposal would provide that whether interest on a loan is permissible under Section 27 of the Federal Deposit Insurance Act would be determined at the time the loan is made, and interest on a loan permissible under Section 27 would not be affected by subsequent events, such as a change in state law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

PROMOTES SAFETY AND SOUNDNESS: The proposal would promote safety and soundness by upholding longstanding principles regarding the ability of banks to sell loans.

- Among other things, loan sales enable state banks to increase their liquidity in a crisis, meet unusual deposit withdrawal demands, pay unexpected debts, and make additional loans.

- Although the proposal does not address which entity is the "true lender" when a state bank makes a loan and assigns it to a third party, the proposal states that the FDIC views 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.

# # #

MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

PATRICK MCHENRY, NC
RANKING MEMBER

January 31, 2020

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: February 5, 2020, "Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps"

The Committee on Financial Services will hold a hearing entitled, "Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps." on February 5, 2020, at 10:00 a.m. in Room 2128 Rayburn House Office Building. This single-panel hearing will have the following witnesses:

- **The Honorable Monique Limón**, Chair, Banking & Finance Committee, California State Assembly
- **Graciela Aponte-Diaz,** Director of Federal Campaigns, Center for Responsible Lending
- **Creola Johnson,** Professor, The Ohio State University Moritz College of Law
- **Lauren Saunders,** Associate Director, National Consumer Law Center
- **Brian Knight**, Director and Senior Research Fellow, Program on Innovation and Governance, Mercatus Center at George Mason University.

Overview

Bank partnerships with non-banks are a rising occurrence in lending.[1] When a loan is originated under such partnership, the bank originates the loan but under the guidelines of the non-bank lender. This loan is then quickly sold to the non-bank lender. The consumer receives the loan from the bank. Under current federal law, national banks and Federal Deposit Insurance Corporation (FDIC)-insured state banks may maintain the maximum interest rates of the states where they are headquartered, meaning they can charge those rates even when lending to borrowers in other states with stricter usury laws.[2] Legal questions have been discussed over the years as to whether the above applies to non-banks that purchase loans from banks in these and other types of partnerships. Some have argued that banks can effectively assign the interest rate exportation power when they sell loans to non-banks, which otherwise do not have such a power as a non-bank. They argue this is permitted through a purported "valid when made" doctrine, which stipulates that a loan that is compliant with the law's usury caps when originated cannot become noncompliant at a later time.[3] Others have disagreed with this interpretation of the "valid when made"

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[1] For example, see U.S. Department of the Treasury, "Opportunities and Challenges in Online Marketplace Lending," May 10, 2016; and U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation," July 31, 2018.

[2] Marquette Nat'l Bank of Minneapolis v. First Omaha Servs. Corp., 439 U.S. 299, 303 (1978); 12 U.S.C. §§ 85, 1831d(a). See generally, Congressional Research Service (CRS) Report, "Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress," May 17, 2019.

[3] *See* Office of the Comptroller of the Currency (OCC) Proposed Rule, Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64,229, 64,231 (November 2019).

doctrine.[4] They have argued that Congress provided banks with the exportation power within the context of a comprehensive regulatory regime, and that banks do not have an inherent power to assign that regime's benefits to entities that are not subject to its restrictions.[5] The National Consumer Law Center points to the "true lender" doctrine that states that if the non-banks have the primary economic interest, then the non-bank is the true lender and they must comply with the state interest rate laws.[6]

Furthermore, consumer advocates and experts have warned of the dangers of "rent-a-bank" partnerships where the sole purpose is for non-banks to use these partnerships to export high cost loans, such as small dollar "payday" loans into states with lower interest rate caps.[7] Short-term, small-dollar loans are consumer loans with relatively low initial principal amounts, and with relatively short repayment periods, generally for a small number of weeks or months. A payday loan is a form of small-dollar loan, typically due on the borrower's next payday. Payday loans are sometimes called cash advance or check advance loans. A car-title loan is another form of a small dollar loan where the borrower's vehicle serves as collateral for the loan. Small-dollar loans are provided by nonbank lenders, such as payday lenders and automobile title lenders. Banks and credit unions offer other forms of small-dollar loans through financial products such as credit cards, credit card cash advances, and checking account overdraft protection programs.[8]

Research has shown that borrowers who take out payday and car-title loans may fall into a harmful debt-trap cycle with deceptively high interest rates. Some states have responded by imposing various interest rate caps and other limitations on these harmful forms of small dollar loans. At the Federal level, there is a 36 percent interest rate cap for many consumer loans provided to active-duty servicemembers and their dependents. In addition, Federal regulators, like the Consumer Financial Protection Bureau (Consumer Bureau or CFPB), have previously sought to further protect consumers through guidance and rulemaking, though recent proposals reverse some of these protections.[9] Consumer advocates warn that rent-a-bank partnerships will allow high cost predatory loans to return to the states where either the voter or the legislature opted to ban them with lower rate caps. This hearing will provide the Committee an opportunity to review these market and policy developments, and to consider legislative options that may better protect consumers.

Consumer Impact of Payday and other Small-Dollar Loans

Small-dollar loans are often used to cover a consumer's cash needs due to unexpected expenses or periods of inadequate income.[10] However, research has shown many payday and car-title loans can be harmful to consumers. According to one estimate, payday and car-title loans carry an annual percentage rate (APR) of 391 percent on average.[11] Many borrowers who take out payday loans roll them over when they come due and take out up to 10 such loans a year, and car-title borrowers generally refinance their

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[4] See Testimony of Adam J. Levitin, Professor of Law, Georgetown University Law Center, before the Committee at a hearing entitled, "Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace," on January 30, 2018. Also see National Consumer Law Center (NCLC), Consumer and Civil Rights Groups Urge Federal Banking Regulator to Stop Rent-a-Bank Payday Loan Schemes (Jan. 22, 2020).

[5] See Motion for Leave to File Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, Rent-Rite Super Kegs West, Ltd. v. World Bus. Lenders, LLC at 31, No. 1:19-cv-01552-REB (Bankr. D. Colo. Sept. 19, 2019).

[6] National Consumer Law Center, FDIC/OCC Proposal would Encourage Rent-a-Bank Predatory Lending (Dec. 2019).

[7] *Id.*

[8] *See* CRS Report, "Short-Term, Small-Dollar Lending: Policy Issues and Implications," (June 14, 2017).

[9] See Full Committee hearing, "Ending Debt Traps in the Payday and Small Dollar Credit Industry," (Apr. 30, 2019).

[10] According to the Federal Reserve, "Four in 10 adults in 2017 would either borrow, sell something, or not be able pay if faced with a $400 emergency expense."

[11] CRL, "The Debt Trap of Triple-Digit Interest Rate Loans: Payday, Car-Title, and High-Cost Installment Loans" (Mar. 20, 2019), https://www.responsiblelending.org/research-publication/debt-trap-triple-digit-interest-rate-loans-payday-car-title-and-high-cost.

loan up to eight times. One out of five car-title borrowers lose their car in repossession. Experts have noted that payday loans often target communities of color, military servicemembers, and seniors,[12] charging billions of dollars a year in unaffordable loans to borrowers with an average annual income of $25,000 to $30,000.[13]

Many payday and car-title loans not only undermine wealth-building opportunities for vulnerable communities, but also force people that are already struggling financially and underbanked into worse circumstances, including losing their bank accounts, vehicles, or even bankruptcy. According to the Center for Responsible Lending (CRL), payday loans cost over $4.1 billion in fees a year for those persons in states that allow triple-digit interest rate payday loans. Car title loans cost consumers over $3.8 billion in fees annually. Together, these loans cost consumers nearly $8 billion in fees every year.[14] CRL also estimates that in states that cap annual interest for these loans at 36 percent or less, consumers save over $5 billion in fees every year—$2.3 billion from payday lending, plus another $2.8 billion from car-title lending.[15]

State Regulation of Payday Loans

According to the CFPB, as of January 2020, 32 states permit payday loans, and 18 states and the District of Columbia either ban payday loans or have regulations that do not allow payday lenders to sustain their business models.[16] Of the states that permit payday loans, 11 states have binding laws regulating payday loans, which generally limit either payday loan size or rollovers, and may set caps in fees and interest rates. Some cities and counties also have local ordinances relating to payday lending.[17]

Caselaw and Federal Policy regarding Rent-A-Banks

There are certain legal precedents set by the Supreme Court and by other federal courts that create some legal framework to rent-a-bank issues. In 1978, the Supreme Court ruled in the case of *Marquette National Bank v. First of Omaha Corp.* that the permissible interest rate national banks can charge is governed by the state usury law of where the bank is headquartered, not where the borrower resides.[18] The 1996 Supreme Court Case, *Barnett Bank of Marion County, N.A. v. Nelson* establishes that federal law can preempt both "inconsistent state laws and state laws that interfere with federal objectives."[19] These federal principles are applied by the Office of the Comptroller of the Currency (OCC) to national banks via the caselaw and via the National Bank Act (NBA), and by the FDIC to FDIC-insured state banks via caselaw and the Federal Deposit Insurance Act (FDI Act).[20]

Advocates argue that these cases do not actually address or legally extend to bank and non-bank partnerships.[21] In the early 2000s, the federal regulators pushed back at the emergence of payday loan focused rent-a-bank partnerships. In fact, then-OCC Comptroller Hawke referred to these rent-a-bank

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[12] https://www.opploans.com/payday-news/who-do-payday-loans-target-and-why/
[13] 82 Fed. Reg. 54581.
[14] Diane Standaert and Delvin Davis, "Payday and Car Title Lenders Drain $8 Billion in Fees Every Year" (Jan. 2017).
[15] *Id.*
[16] According to the CFPB's proposed rule from February 2019, as of the date of the rule, p.32: CFPB, "Payday, Vehicle Title, and Certain High-Cost Installment Loans," 84 Federal Register 4252, Feb. 14, 2019.
[17] The National Conference of State Legislatures (NCSL) has compiled a list of payday lending laws by state. The list is current as of January 23, 2018 and can be found at: http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.
[18] Marquette Nat'l Bank v. First of Omaha Corp., 439 U.S. 299 (1978).
[19] Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 33 (1996).
[20] CRS, "Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress," May 17, 2019.
[21] National Consumer Law Center, *supra* note 6.

plans as "an abuse of the national Charter."[22] Comptroller Hawke further cautioned, "In the case of the payday lending industry....the OCC has opposed arrangements in which third parties effectively 'rent out' the preemption privileges of a national bank for the sole purpose of evading state law."[23]

A critical case that addresses these topics is *Madden v. Midland Funding, LLC*, which was decided by the Second Circuit court in 2015.[24] The Second Circuit court in this case declined to apply the "valid when made" doctrine, and held that a non-bank debt collector could *not* benefit from the exportation power of a national bank from which it had purchased credit-card debt.[25] In *Madden*, a New York borrower sued a debt collector for violating New York usury law because the interest rate on her debt exceeded New York's limit of 25 percent per year.[26] In response, the debt collector argued that the NBA preempted the borrower's New York usury claim because the debt had been originated by a Delaware-based national bank and was not usurious under Delaware law.[27] The Second Circuit sided with the borrower, reasoning that New York usury law would not "significantly interfere" with the national bank's powers because the debt collector was a separate entity and was not acting on the bank's behalf.[28]

In November and December of 2019, respectively, the OCC and FDIC proposed rules that would override the *Madden* decision and adopt the "valid when made" principle for bank-originated loans.[29] The OCC's proposed rule would amend its regulations governing national banks to provide that "[i]nterest on a loan that is permissible under [Section 85 of the NBA] shall not be affected by the sale, assignment, or other transfer of the loan."[30] In its Notice of Proposed Rulemaking (NPRM), the OCC explained that it was issuing the proposal in response to regulatory uncertainty created by the *Madden* decision, and that "various provisions of Federal banking law" support its interpretation of the exportation power.[31] Specifically, the agency argued that its view of the exportation power derives support from (1) the "valid when made" doctrine, (2) banks' power to sell and assign loans, and (3) the purpose of Section 85 of the NBA "to facilitate banks' ability to operate across state lines by eliminating the burden of complying with each state's interest laws."[32] While the OCC argued that a contrary rule would "unduly curtail" national banks' power to sell and assign loans, the agency did not explicitly invoke either *Barnett Bank* or its "significant interference" test.[33]

The FDIC's proposed rule would adopt a similar regulation for FDIC-insured state banks. The proposed regulation would provide that "[w]hether interest on a loan is permissible under [Section 27 of the FDI Act] is determined as of the date the loan was made," and that such a determination "shall not be affected by any subsequent events," including the "sale, assignment, or other transfer of the loan."[34] Like the OCC, the FDIC identified regulatory uncertainty created by *Madden* to justify its NPRM.[35] The agency

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[22] Office of the Comptroller of the Currency, "Comptroller Calls Preemption a Major Advantage of National Bank Charter" (2002), *available at* https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.
[23] Id.
[24] Madden v. Midland Funding, LLC, 786 F.3d 246, 249-53 (2d Cir. 2015).
[25] 786 F.3d 246, 249-53 (2d Cir. 2015).
[26] *Id.* at 248.
[27] *Id.* at 248-49.
[28] *Id.* at 251-53.
[29] *See* OCC Proposed Rule, *supra* note 3; FDIC Proposed Rule, Federal Interest Rate Authority, 84 Fed. Reg. 66,845, 66,848 (December 2019).
[30] OCC Proposed Rule, *supra* note 3, at 64,232. The OCC's proposed rule also includes a similar provision that would amend its regulations governing federal savings associations, *id.*, which possess the same exportation power as national banks, 12 U.S.C. § 1463(g).
[31] OCC Proposed Rule, *supra* note 3, at 64,230.
[32] *Id.* at 64,230-231.
[33] *Id.* at 64,231.
[34] FDIC Proposed Rule, *supra* note 28, at 66,853.
[35] *Id.* at 66,845, 66,848-849.

also appealed to banks' power to sell and assign loans and the purpose of Section 27 of the FDI Act as the legal authority supporting its interpretation of the exportation power.[36] While the FDIC noted that its NPRM was "consistent" with the "valid when made" principle, it maintained that the proposal was not "based on" that doctrine.[37] The OCC accepted comments on its proposed rule until January 21, 2020,[38] while the FDIC will accept comments until February 4, 2020.[39]

Consumer law advocates and experts have expressed their deep concerns about the proposed rules and possible corresponding guidance. The National Consumer Law Center notes that the proposals are both silent on the "true lender" doctrine and fail to provide evidence that the *Madden* decision has had a negative impact on the market or on consumer access to credit.[40] Other consumer organizations point to the dangers of allowing rent-a-bank partnerships to force the return of triple-digit interest loan products to the states and territories that pushed them out to protect their residents.[41] In 2017, State Attorneys General from 20 states wrote to Congress opposing provisions essentially overturning *Madden* in the Financial CHOICE Act (H.R. 10). The letter noted that the bill "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps." [42] More recently, stakeholders have warned that states with newly established state rate caps like California risk seeing a federally legal return of these products through rent-a-bank partnership.[43]

Legislation

- **H.R. 5050, The Veterans and Consumers Fair Credit Act** (Garcia-Grothman). This bipartisan legislation sponsored by Representatives Jesus "Chuy" Garcia (D-IL) and Glenn Grothman (R-WI) would impose a federal 36 percent usury APR cap for certain consumer loans, including payday loans and car-title loans. Specifically, the bill extends the current 36 percent interest rate cap protections for certain consumer loans established under Military Lending Act (MLA) to all consumers, including veterans and their families. The proposal would not preempt stricter state laws, and it would create specific penalties for violations of the cap and allows for enforcement through civil courts and by state Attorneys General. This proposal has been endorsed by a wide coalition of military and veteran advocacy organizations, along with consumer and civil rights groups and faith-based organizations.[44]

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[36] *Id.* at 66,848.
[37] *Id.*
[38] OCC Proposed Rule, *supra* note 3, at 64,229.
[39] FDIC Proposed Rule, *supra* note 28, at 66,845.
[40] National Consumer Law Center, supra note 6. Also see FDIC Proposed Rule, *supra* note 28, at 66,850 ("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.")
[41] Center for Responsible Lending, Americans for Financial Reform, and National Consumer Law Center, FDIC/OCC Proposal Would Encourage Rent-a-Bank High-Cost Predatory Lending (2019), *available at* https://www.responsiblelending.org/media/fdic-occ-proposal-would-encourage-rent-bank-high-cost-predatory-lending.
[42] State of New York Office of the Attorney General letter to Congress opposing the Financial CHOICE Act (June 2017), *available at* https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.
[43] National Consumer Law Center, Issue Brief: Payday Lenders Plan to Evade California's New Interest Rate Cap Law Through Rent-A-Bank Schemes (2019), *available at* https://www.nclc.org/issues/ib-rent-a-bank.html.
[44] See Press Release, "Reps. García, Grothman Introduce Bipartisan Veterans and Consumers Fair Credit Act ," Nov. 12, 2019; Military and Veteran Organization Support Letter; Consumer Federation of America, "Landmark Bipartisan Bill Will Protect Consumers and Veterans from Predatory Lending," Nov. 12, 2019.

TAB 2

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, LTD. AND CONSUMER SERVICE ALLIANCE OF TEXAS, PLAINTIFFS,	§	
V.	§	CAUSE NO. A-18-CV-0295-LY
CONSUMER FINANCIAL PROTECTION BUREAU AND KATHLEEN KRANINGER, IN HER OFFICIAL CAPACITY AS DIRECTOR, CONSUMER FINANCIAL PROTECTION BUREAU, DEFENDANTS.	§	

ORDER

Before the court is the above styled and numbered cause. The court stayed litigation in this action and stayed the compliance date of August 19, 2019, for the Consumer Financial Protection Bureau's ("Bureau") "Payday, Vehicle Title, and Certain High-Cost Installment Loans" rule ("Rule"). *See* 82 Fed. Reg. 54,472 (Nov. 17, 2017). Additionally, the court ordered the parties to file periodic joint status reports informing the court about proceedings related to the Rule and this action. By way of background, the Bureau initiated a rulemaking process that revisits one aspect of the Rule–the underwriting provisions–but not the payment provisions of the Rule. *See* 84 Fed. Reg. 4252 (Feb. 14, 2019) (proposing to rescind underwriting provisions); 84 Fed. Reg. 4298 (Feb. 14, 2019) (proposing to delay August 19, 2019 compliance date for underwriting provisions to November 19, 2020).

Pending before the court is the parties' periodic Joint Status Report filed December 6, 2019 (Clerk's Document No. 65). The parties inform the court that on June 6, 2019, the Bureau issued

a final rule that delayed the compliance date for the underwriting provisions until November 19, 2020. *See* 84 Fed. Reg. 27907 (published June 17, 2019) (effective August 16, 2019). The report informs the court that the Bureau is "continuing to make progress on its other rulemaking, which proposed to rescind the underwriting provisions." None of the parties request the court lift the stay of litigation or the stay of the compliance date at this time.

Having considered the case file, the Joint Status Report filed December 6, 2019, and the applicable law,

IT IS ORDERED that the stay of litigation and the stay of the compliance date are continued in full force and effect.

IT IS FURTHER ORDERED that the parties file a Joint Status Report informing the court about proceedings related to the Rule and this litigation as the parties deem appropriate, **but no later than Friday, April 24, 2020.**

SIGNED this 6th day of December, 2019.

LEE YEAKEL
UNITED STATES DISTRICT JUDGE

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December 13, 2018

VIA HAND DELIVERY

Brian Johnson, Acting Deputy Director
Office of the Director
Bureau of Consumer Financial Protection
1700 G Street N.W.
Washington, DC 20552

Dear Deputy Director Johnson:

Please find enclosed a petition for rulemaking and supplemental comments regarding the Bureau's Final Rule regulating Payday, Vehicle Title, And Certain High–Cost Installment Loans. The petition and comments request that the Bureau, as part of its currently pending reconsideration of that Rule, exempt debit card payments from the Rule's payment provisions. As the petition and comments explain, the decision to include debit card payments was unsupported and irrational, and that error should be addressed and corrected **at the same time that the Bureau reconsiders the Rule's ability-to-pay provisions** so as to ensure that there is a level playing field across these different segments of the consumer-lending industry.

I would be happy to discuss the petition and comments, and I thank you for your consideration.

Sincerely,

Andrew M. Grossman
Counsel to Advance Financial

Enclosure

Petition for Rulemaking and Supplementary Comment
From Advance Financial,
To the Bureau of Consumer Financial Protection

December 13, 2018

Docket No. CFPB-2016-0025

Filed via email to cfpb_reginquiries@cfpb.gov and
FederalRegisterComments@cfpb.gov and via Hand Delivery to:

Kathy Kraninger, Director
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Brian Johnson, Acting Deputy Director
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Kelly Cochran, Assistant Director
Office of Regulations
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1700 G St. N.W.
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I. Introduction and Summary

Pursuant to the First Amendment to the United States Constitution and 5 U.S.C. § 553(e), Advance Financial hereby petitions and submits these supplemental comments to the Bureau of Consumer Financial Protection to amend its Final Rule regulating Payday, Vehicle Title, And Certain High–Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017), to exempt debit card transactions from provisions regulating payment transfers.

The Final Rule brushed aside recommendations by the Small Business Review Panel, 18 state attorneys general, and numerous small business representatives, credit unions, community banks, and other industry participants to exclude debit card transactions from the Final Rule's payment provisions. Instead, the Final Rule treated them the same as check and ACH payments, despite recognizing that denied debit card payments do not present the very risk of consumer harm that the Bureau relied upon as the basis for the payment provisions because debit card payments rarely (if ever) result in consumers being charged insufficient funds fees. That decision was completely unsupported and, in fact, conflicts with substantial record evidence demonstrating the benefits to consumers of debit card repayment.

Perversely, by treating debit card payments the same as ACH and check payments, the Final Rule reduces incentives for lenders to allow consumers to use the most popular payment method that typically avoids the precise consumer harm that the Bureau sought to address with the payment provisions: mounting insufficient funds fees.

The Final Rule's error in failing to exclude debit card payments from its payment provisions needs to be corrected now in conjunction with the Bureau's reconsideration of the Final Rule's ability-to-pay provisions. The current state of regulatory uncertainty is causing lenders to evaluate whether longer-term, multi-payment transactions and allowing repayment by debit card make sense. A reconsideration process that provides regulatory relief only on the ability-to-repay issue will actually limit consumers' ability to choose longer-term credit products with more affordable installments that avoid balloon payments and to employ a payment method that avoids mounting insufficient funds fees. By contrast, acting now, in concert with reconsideration of the ability-to-pay provisions, would promote more affordable credit options and the use of debit card payments limiting consumer's exposure to costly fees. In this respect, excluding debit card payments from the Final Rule's payment provisions goes hand-in-hand with the Bureau's reconsideration of the ability-to-pay provisions.

Accordingly, the Petitioner respectfully requests that the Bureau amend the Final Rule to exclude debit card payments and that it do so in conjunction with its reconsideration of the Final Rule's ability-to-pay provisions.

II. Legal Background

The Bureau is responsible for "regulat[ing] the offering and provision of consumer financial products or services under the Federal consumer financial laws." 12 U.S.C. § 5491. As relevant here, Section 1031 of the Dodd-Frank Act authorizes the Bureau to exercise rulemaking authority "to prevent a covered person or service provider from committing or engaging in an unfair, deceptive,

or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service." 12 U.S.C. § 5531(a); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 1376, 2005.

The statute defines an "unfair" or "abusive" act or practice. An "unfair" act or practice is "likely to cause substantial injury to consumers which is not reasonably avoidable by consumers" and "not outweighed by countervailing benefits to consumers or to competition." 12 U.S.C. § 5531(c). An "abusive" act or practice is one that "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service" or "takes unreasonable advantage of" the consumer's ignorance of material terms or conditions, the consumer's inability to protect his own interests, or the consumer's reasonable reliance that the lender is acting in his best interest. *Id.* § 5531(d). If an act or practice is identified as unfair, deceptive, or abusive, then the Bureau has the authority to "prescribe rules" preventing such acts or practices. *Id.* § 5531(b). Thus, to regulate an act or practice, the Bureau must find that it is unfair or abusive. Absent such a finding, the Bureau has no basis or authority to regulate.

In November 2017, the Bureau identified what it deemed three unfair and abusive practices, one of which is relevant to this comment and rulemaking petition. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (codified at 12 C.F.R. pt. 1041). After

making its findings, the Bureau issued a rule (the "Final Rule") prescribing those practices. The Final Rule includes three main sections, which have been referred to as the "ability-to-pay" provisions, the "payment" provisions, and the "notice" provisions. This petition and comment addresses only one aspect of the Final Rule's payment provisions that is unsupported by the requisite finding of unfairness or abusiveness and, in fact, discourages use of a payment method that can help consumers avoid the very unfair and abusive element of other payment methods the Bureau sought to curtail.

The Bureau claimed authority to promulgate the payment provisions based on the following finding:

> It is an unfair and abusive practice for a lender to make attempts to withdraw payment from consumers' accounts in connection with a covered loan after the lender's second consecutive attempts to withdraw payments from the accounts from which the prior attempts were made have failed due to a lack of sufficient funds, unless the lender obtains the consumers' new and specific authorization to make further withdrawals from the accounts.

12 C.F.R. § 1041.7 (2018). To prevent that practice, the Bureau issued a rule that prohibits lenders from "initiat[ing] a payment transfer from a consumer's account in connection with any covered loan that the consumer has with the lender after the lender has attempted to initiate two consecutive failed payment transfers from that account in connection with any covered loan that the consumer has with the lender." *Id.* § 1041.8 (b)(1).

The regulation defines a "payment transfer" as "any lender-initiated debit or withdrawal of funds from a consumer's account for the purpose of collecting any amount due or purported to be due in connection with a covered loan." *Id.* § 1041.8(a)(1). In its official interpretations of the Final Rule, the Bureau clarified that the definition of "payment transfer" means, among other payment methods, "[a]ny electronic fund transfer meeting the general definition in § 1041.8(a)(1)..., including but not limited to an electronic fund transfer initiated by a debit card or a prepaid card." 82 Fed. Reg. at 54,910. As a result, the payment provisions generally apply, on equal terms, transactions involving checks, ACH transfers, and debit or prepaid cards.

In the notice and comment period, industry members expressed their concern that the definition of payment transfer was insupportably overbroad. They argued that, although the Bureau's finding may support regulation of payments through such means as checks or ACH transfers where a denied payment can and likely would result in overdrafts and insufficient fund fees, that rationale does not extend to payments made through debit cards. Unlike a check or ACH transfer, a denied debit card transaction generally does not incur denial fees or result in an overdraft—instead, the payment is simply denied. Accordingly, they argued, subjecting debit card payments to the payment provisions was unsupported, unnecessary, and therefore arbitrary and capricious. As the Bureau explained in the Final Rule's preamble:

> During the SBREFA process and in outreach with industry in developing the proposal, some lenders

recommended that the Bureau take a narrower approach in connection with payment attempts by debit cards. One such recommendation suggested that the prohibition against additional withdrawal attempts should not apply when neither the lender nor the consumer's account-holding institution charges an NSF fee in connection with a second failed payment attempt involving a debit card transaction that is declined. As explained in the proposal, the Bureau understood that depository institutions generally do not charge consumers NSF fees or declined authorization fees for such transactions, although it was aware that such fees are charged by some issuers of prepaid cards. It thus recognized that debit card transactions present somewhat less risk of harm to consumers.

For a number of reasons, however, the Bureau did not believe that this potential effect was sufficient to propose excluding such transactions from the rule. First, the recommended approach would not protect consumers from the risk of incurring an overdraft fee in connection with the lender's third withdrawal attempt. As discussed in Market Concerns—Payments, the Bureau's research focusing on online lenders' attempts to collect covered loan payments through the ACH system indicates that, in the small fraction of cases in which a lender's third attempt succeeds—i.e., after the lender has sufficient information indicating that the account is severely distressed—up to one-third of the successful attempts are paid out of overdraft coverage. Second, the Bureau believed that the recommended approach would be impracticable to comply with and enforce, as the lender initiating a payment transfer would not necessarily know the receiving account-holding institution's practice with respect to charging fees on declined or returned transactions. Additionally, the Bureau was concerned that lenders might respond to such an approach by seeking to evade the rule by re-characterizing their fees in some other manner. It thus believed that it was not appropriate to propose that

> payment withdrawal attempts by debit cards or prepaid cards be carved out of the rule, in light of the narrow range of those situations, the administrative challenges, and the residual risk to consumers.

Id. at 54,750.

The concerns raised by industry leaders were shared by many state law-enforcement officers responsible for policing unfair and abusive financial practices within their states. In particular, the Attorneys General of Arkansas, South Carolina, Alabama, Florida, Georgia, Indiana, Kansas, Louisiana, Nebraska, Nevada, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Utah, West Virginia, and Wisconsin stated in their joint comments to the Bureau:

> The Proposed Rule should likewise be revised to incorporate industry's suggestions that the prohibition against repeated presentments not apply to debit card transactions. The Proposed Rule purports to justify imposing a two transaction limit on the grounds that repeated presentments result in repeated non-sufficient funds fees. *See* 81 FR 47929/3 ("Bounced checks and failed [automated transaction] payments can be quite costly for borrowers. The median bank NSF fee is $34[.]"); 81 FR 48049/2 (similar); 81 FR 48057/2 (contending restriction is necessary because NSF fees can quickly diminish consumer deposits); *see also* 81 FR 47934/1 (discussing NSF fees and arguing they aggravate risks associated with payday loans). Yet as previous commenters have observed—and the Proposed Rule concedes—those concerns do not apply to the overwhelming majority of debit card transactions because "depository institutions generally do not charge consumers a [non-sufficient funds] fee or declined authorization fees for declined debit card transactions." 81 FR 48066/1. And in declining to create an exemption, the Proposed Rule merely argues

> that "it is not appropriate to propose carving out of the rule payment withdrawal attempts by debit cards... given the narrow circumstances in which the carve-out would apply, administrative challenges, and residual risks to consumers." 81 FR 48066/2; *see also* 81 FR 48066/1. Thus, in other words, the Proposed Rule failed to incorporate a justifiable exemption because it would be narrow- which is often true of exemptions- and would require the CFPB Director to do extra work. Those factors hardly justify failing to create an exemption, and accordingly, the Proposed Rule should be revised.

Comment of Attorneys General of Arkansas, South Carolina, Alabama, Florida, Georgia, Indiana, Kansas, Louisiana, Nebraska, Nevada, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Utah, West Virginia, and Wisconsin, Docket No. CFPB-2016-0025, Oct. 7, 2016, at 20–21. The Bureau acknowledged the comment, stating that, "[s]everal commenters, including State Attorneys General, argued that payments made using debit cards should be exempt because they generally do not engender NSF fees, and thus, the harm justifying the identified unfair and abusive act or practice is diminished for debit card payments." 82 Fed. Reg. at 54,746.

The Bureau acknowledged that a denied debit card transaction generally does not create "NSF [Not Sufficient Funds], overdraft, return payment fees, or similar fees, and [would] not close accounts because of failed payment attempts," and thus *"the harms underpinning the unfair and abusive practice...would not occur." Id.* (emphasis added). The Bureau even conceded that "the rule does not need to cover those instances." *Id.* Yet despite recognizing that debit card

payments are unlike check or ACH transfers, would not cause the unfair or abusive harms identified as the basis for the payment provisions, and do not need to be covered by the Final Rule, the Bureau arbitrarily and inexplicably applied the new restrictions to debit cards:

> [T]he Bureau has decided not to exempt payments made using debit cards from the rule. First, while failed debt card transactions may not trigger NSF fees, some of them do trigger overdraft fees, even after two failed attempts, as our study showed. Second, lenders may still charge return fees for each presentment. And third, the Bureau does not believe an exclusion based on payment type would work to alleviate much compliance burden associated with § 1041.8 because the lender would need to develop processes and procedures for those payment types that are covered regardless. In fact, juggling multiple, disparate processes and procedures depending on payment type would involve its own compliance burdens.

Id. at 54,747.

The Final Rule provided that the payment provisions at issue here would go into force on August 19, 2019.[1] *Id.* at 54,472. In November 2018, however, a federal court indefinitely stayed the compliance date pending further order. Order, *Community Financial Services Association of America, Ltd. et al., v. Consumer Financial Protection Bureau et al.*, 2018 WL 3491029 (W.D. Tex.) (Nov. 6, 2018).

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[1] All of the provisions of the Final Rule initially had a compliance date of August 19, 2019, except for three provisions: Section 1041.1 (authority and purpose), Section 1041.11 (registered information systems), and Section 1041.14 (severability).

Shortly before the compliance date was stayed, the Bureau indicated that it was reconsidering the scope of the Final Rule. It issued a statement providing that it was "planning to propose revisiting only the ability-to-repay provisions and not the payments provisions, in significant part because the ability-to-repay provisions have much greater consequences for both consumers and industry than the payment provisions." Public Statement Regarding Payday Rule Reconsideration and Delay of Compliance Date, Consumer Financial Protection Bureau, October 26, 2018. The Bureau has subsequently suggested that it may revisit the Final Rule's payment provisions in a subsequent proposal.

III. The Bureau Should Exclude Debit Cards from the Final Rule

The Bureau should exclude debit cards from the payment provisions in the Final Rule because the decision to include debit cards was arbitrary and capricious, contrary to law, and in excess of the Bureau's authority. *See* 5 U.S.C. § 706(2). The Bureau's rulemaking authority is limited to regulating acts and practices that are unfair or abusive. Unlike other payment types subject to the Final Rule, such as ACH and check transfers, debit card transactions do not pose any risk of likely substantial injury to consumers, as the Bureau itself acknowledged. Even assuming *arguendo* that debit cards could pose a substantial risk of harm, their benefits to consumers outweigh the potential harm. And, as a procedural matter, it would be easy for the Bureau to exclude debit card transactions from the payment provisions: the existing rulemaking record supports that result, and all that is required is a single, one-sentence amendment

modeled on the exemption in Section 1041.8(a)(1)(ii) for certain account-holding institutions.

A. Debit Card Transactions Are Unlike ACH and Check Transfers

The Bureau's regulatory authority under Dodd-Frank is limited to making rules that prescribe acts or practices that are unfair or abusive. *See* 12 U.S.C. § 5531(a). In identifying its basis for exercising regulatory authority, the Bureau found that it is an unfair and abusive practice for a lender to make more than two consecutive attempts to withdraw funds from accounts when the withdrawal attempt was denied for lack of sufficient funds, unless the lender obtains the consumers' new and specific authorization to make further withdrawals from the accounts. 12 C.F.R. § 1041.7 (2018).

The stated rationale for this prohibition was that "each additional attempt by the lender is *likely to trigger substantial additional fees* for the consumer but is unlikely to result in successful collection for the lender. These additional attempts can cause serious injury to consumers who are already in substantial financial distress, including the cumulative fees." Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. at 54,733 (emphasis added). The Bureau studied ACH transfers and found that consumers may incur up to $100 in NSF fees from their account-holding institution after just two failed attempts to withdraw funds, which injures consumers who then incur substantial fees without having completed the original payment. *Id.* Thus, to prevent what it identified as an unfair and abusive lending practice for ACH transfers, the Bureau prohibited lenders from initiating a payment transfer after two

consecutive failed attempts for ACH transfers, checks, and debit card payments. 12 C.F.R. § 1041.8(b). The stated purpose was to prevent consumers from being subjected, without their additional express authorization, to excessive fees from their account-holding institution for denied transactions after successive attempted withdrawals.

The problem with this approach is that it applies too broadly because of how the Bureau defined payment transfer. *Id.* § 1041.8(a)(1). In the definition of a payment transfer, the Bureau included debit or withdrawal payments initiated through check, ACH, *and debit card. Id.* Based on the Bureau's own stated purpose for the payment limitations, that definition arbitrarily includes a payment method that is neither unfair nor abusive—namely, debit card transactions, which are unlike ACH and check payment transfers. Although check and ACH transfers typically cause consumers to incur fees from multiple failed attempts to withdraw funds, debit card payments rarely (if ever) result in such fees from their account-holding institutions. As the Bureau itself has recognized,

> Generally, if you overdraw your checking account by a check or ACH, your bank or credit union's overdraft program will pay for the transaction and charge you a fee. By allowing your account balance to fall below $0, your bank or credit union will also effectively take the repayment right out of your next deposit. At most institutions, the overdraft fee is a fixed amount regardless of the transaction amount, and you can incur several overdraft fees in a single day.... Overdraft fees work a little differently for debit cards. Your bank or credit union cannot charge you fees for overdrafts on

> ATM and most debit card transactions unless you have agreed ("opted in") to these fees.

Gary Stein, *Understanding the Overdraft "Opt-in" Choice*, Consumer Financial Protection Bureau (January 19, 2017)[2]; *see also* Requirements for Overdraft Services, 12 C.F.R. § 1005.17. Because the rationale and statutory justification for the payment provisions was to prevent excessive fees likely to be incurred by consumers from failed payment attempts, the decision to include debit cards was arbitrary—indeed, that decision conflicts with the Bureau's stated rationale. And in arbitrarily including debit cards in the Final Rule, the Bureau exceeded its statutory authority to regulate and the Administrative Procedure Act's requirement for reasoned rulemaking.

The Bureau implicitly acknowledged this to be true when it distinguished ACH transactions from debit card transactions. As the Bureau recognized in its study, "Fees on [ACH] transactions are not subject to an opt-in requirement like overdraft fees on debit card transactions, meaning that while it is true borrowers may have opted into overdraft fees for some instances, that is not true for many instances in which overdraft fees are incurred." 82 Fed. Reg. at 54,735. The Bureau further reiterated that "account-holding institution[s] may not charge a fee [on] attempts made by debit cards and certain prepaid cards." *Id.* at 54,734.

Simply put, when a lender attempts to deposit a check or initiate an ACH transfer and the consumer's balance is insufficient, the consumer's bank

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[2] *Available at* https://www.consumerfinance.gov/about-us/blog/understanding-overdraft-opt-choice.

typically charges an NSF fee, and the lender may charge an NSF fee, as well. In contrast, when a lender tries to initiate payment through a debit card, the bank will typically either accept or decline the authorization request, without imposing any fee when the request is denied for insufficient funds. Unlike with checks and ACH transfers, overdrafts or overdraft fees are permitted only when account-holders have specifically and voluntarily authorized overdraft protection, *see* 12 C.F.R. § 1005.17, which (as the Bureau found) most have not, *see* 82 Fed. Reg. at 54,750/3. Furthermore, unlike with check and ACH payments, lenders do not charge fees for denied debit card payments. In fact, state laws permitting fees for insufficient funds generally do not even apply to denied debit card payments. So while borrowers may face the risk of mounting NSF fees from both the borrower's account-holding institution and the lender with check or ACH payments, debit card payments do not pose that risk.

In short, the rationale relied upon in the Final Rule to regulate other forms of payment does not extend to debit card payments. The Final Rule failed to identify any basis to conclude otherwise, arbitrarily relying on ACH-transaction data and ignoring that consumers who may be subject to fees because of a denied debit card payment affirmatively consented to them and have the absolute right to revoke such consent. *Id.* at 54,847 (providing the Bureau's analysis of ACH data). The rules and restrictions applicable to debit card payments already place strong protections on any fees associated with overdrafts. Arbitrarily lumping debit card payments in with checks and ACH transfers results in heavier burdens on debit card payments and thereby disincentivizes lenders from using a

payment method that has more protections and is less costly to consumers. That is illogical and contrary to the stated purpose of the payment provisions.

B. The Finding of Substantial Harm to Consumers Is Unsupported

For the Bureau to exercise regulatory authority, it must also show that an act or practice will substantially injure a consumer, materially interfere with a consumer's ability to understand the product or service, or unreasonably take advantage of a consumer. 12 U.S.C. § 5531(c)–(d). Absent such a showing, the Bureau is prohibited from regulating.

The Bureau should exclude debit card transactions from the Final Rule's payment provisions because there has been no finding of harm or even evidence to support such a finding with respect to such transactions and any implied finding of harm would be insufficient to justify the exercise of regulatory authority. As explained above, the Final Rule's rationale for regulating payments was to protect consumers from the harms of excessive fees based on insufficient funds. But unlike checks and ACH debits, debit card transactions do not pose such risks. If the account lacks adequate funds to cover the debit, the transaction is simply denied. Likewise, lenders offering covered loans subject to the Final Rule do not charge NSF fees for debit card transactions. Only when a consumer has expressly chosen to obtain overdraft coverage is a bank fee even possible, and as the Bureau has acknowledged, the vast majority of consumers do not make such an election. For the few who have specifically and voluntarily elected to have overdraft protection, they do so specifically to obtain the protections it provides.

Furthermore, the Bureau inexplicably relied on an examination of ACH transfer data in determining that consumers needed to be protected from mounting NSF fees following a second consecutive failed payment attempt. The Bureau did not examine similar debit card payment data. Reviewing such data would have revealed that consumers are rarely charged overdraft fees by their financial institutions for denied debit card payments, that state laws generally do not authorize lenders to charge NSF fees for denied debit card payments, that debit card rules may prohibit the charging of such fees, and that lenders of "covered loans" rarely, if ever, charge a fee for a denied debit card payment. Including debit card payments in the payment provisions is attempting to solve a problem that does not exist and, in doing so, actually harms consumers.

The State Attorneys General correctly identified the lack of evidentiary support for the decision to include debit card transactions. As their comment described, "the Proposed Rule concedes [that] those concerns do not apply to the overwhelming majority of debit card transactions because 'depository institutions generally do not charge consumers a [NSF] fee or declined authorization fees for declined debit card transactions.'" Comment from State Attorneys General, *supra*, at 21.

Other commenters identified the Bureau's lack of evidentiary support for its decision to include debit card transactions. For example, one industry participant noted that "the CFPB has shown no research indicating consumers incur a disproportionate number of insufficient funds fees from covered loan products...Furthermore, debit card payments and other forms of payment which

do not result in the consumer incurring fees should certainly not be subject to this proposal." Comment on the Proposed Payday Rule from Checkmate at 7 (Oct. 7, 2016). Likewise, another comment by an industry participant observed that the Bureau "does not take into account that other market alternatives to ACH or RCC payments, such as debit card authorizations, do not cause NSF fees" and "fails to account for the fact that overdraft fees will only occur if the consumer has voluntarily elected for overdraft protection at their financial institution." Comment from Check Into Cash, Inc. on the Proposed Payday Rule (Oct. 4, 2016).

In short, the Bureau relied on inapplicable data, arbitrarily failed to consider the material ways in which debit card transactions differ from other payment mechanisms, and failed to identify any evidence supporting a finding that debit card transactions likely impose substantial harm on consumers. In fact, the Bureau acknowledged that debit card payments are *not likely* to impose substantial harm on consumers. Accordingly, the decision to include debit cards in the payment provisions was arbitrary.

C. The Final Rule's Asserted Compliance and Enforcement Challenges Are Illusory

The Bureau stated in the Final Rule that it "decided not to exempt payments made using debit cards from the rule" because it did "not believe an exclusion based on payment type would work to alleviate much compliance burden associated with § 1041.8." 82 Fed. Reg. at 54,747. It concluded that the compliance burden would exist regardless "because the lender would need to

develop processes and procedures for those payment types that are covered regardless. In fact, juggling multiple, disparate processes and procedures depending on payment type would involve its own compliance burdens." *Id.*

The Bureau's claims that excluding debit card payments would not "alleviate much compliance burden" and could even increase compliance costs were completely unsupported and are contrary to information provided by industry and plain common sense—after all, alternative means of collection, such as litigation, obviously impose far greater costs. And the unsupported assertion that an exclusion would increase compliance burdens by requiring lenders to "juggl[e] multiple, disparate processes and procedures depending on payment type" ignores that different payment types are already subject to different compliance regimes and that lenders, as a result, already are forced to employ "multiple, disparate processes and procedures depending on payment type." Given that reality, an exclusion could only reduce compliance burden. And the magnitude of that reduction would be significant, in light of the Final Rule's burdens. The payment provisions will significantly increase compliance costs on all payment transfer methods—specifically in terms of notifications, communications, and litigation. If debit card payments are excluded from the payment provisions, then lenders will be able to limit the increase in compliance costs associated with check and ACH transfer payments.

Likewise, the Final Rule's bare assertions of unidentified "administrative challenges" and enforcement challenges find no record support and ignore the

pervasive regulation, at the state and federal levels, of debit card networks and transactions. As the State Attorneys General observed,

> in declining to create an exemption, the Proposed Rule merely argues that 'it is not appropriate to propose carving out of the rule payment withdrawal attempts by debit cards...given the narrow circumstances in which the carve-out would apply, administrative challenges, and residual risks to consumers.' Thus, in other words, the Proposed Rule failed to incorporate a justifiable exemption because it would be narrow—which is often true of exemptions—and would require the CFPB Director to do extra work. Those factors hardly justify failing to create an exemption, and accordingly, the Proposed Rule should be revised.

Comment from State Attorneys General, *supra*, at 21 (citations omitted). The Bureau oddly argues that an exemption for debit card payments is not warranted because it would apply only in "narrow circumstances." But the fact that debit card payments rarely (if ever) incur any NSF fees is reason enough to exempt them from the definition of payment transfer in the first place. Further, it defies logic to suggest that debit card payments are not a significant enough issue to create an exemption. That is the entire point of the comment from the State Attorneys General: debit card payments do not cause the harms the rule intends to cure (excessive NSF fees) and so regulating them will increase administrative burdens for lenders and impose risks and higher costs on consumers, without any countervailing benefit.

Industry members agreed:

> Given that FFA members offer their consumers various options to repay their transactions, some of which

> include debits from their bank accounts using debit cards, we encourage the CFPB to...reconsider its approach to debit cards. Debit cards are rejected by the banking system when consumers do not have sufficient funds in their account. So NSF fees do not arise. Use of the debit cards networks is widely understood by regulators, and the CFPB polices that industry well. Thus, *enforcement challenges should not exist.*

Comment on the Payday Rule from the Flexible Finance Association at 26 (Oct. 6, 2016) (emphasis added).

Furthermore, the Bureau's claim that including debit cards is justified because "a single definition is a simpler approach" and "more administrable as a practical matter" is unsupported and illogical. Exempting debit card transactions would create no compliance burden, and there is no record evidence to the contrary. Indeed, such an exemption would be more easily administrable than the exclusion provided in Section 1041.8(a)(1)(ii), which creates a *conditional* exclusion for certain transfers by account-holding institutions. By definition, a *conditional* exclusion is more complicated and burdensome to apply than a straightforward *categorical* exclusion, such as for debit card transactions. Moreover, it is completely arbitrary and illogical to acknowledge debit card transactions are unlike ACH and check transfers but then persist in regulating debit card payments just to have a "single definition" when the regulation (because of the existing exclusion) already abandoned the idea of employing a "single definition."

D. The Final Rule's Regulation of Debit Card Transactions Actually Injures Consumers

The Bureau's authority to regulate is further limited by the statutory requirement that even a substantially harmful act or practice is permitted if the countervailing benefits to consumers or competition outweigh the harm. 12 U.S.C. § 5531(c). Likewise, the Bureau is obligated to consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule." 12 U.S.C. § 5512(b)(2)(A)(i). For the reasons stated in Section III (A)–(B), *supra*, debit card repayment does not cause substantial harm to consumers. But even if such harm existed, it is outweighed by the countervailing benefit of access to (1) a form of repayment that is unlikely to subject consumers to the kind of mounting NSF fees the Bureau cites as unfair and abusive and (2) more flexible longer-term loans that employ debit card payment options. The Bureau's consideration of only (purported) costs, while ignoring these benefits, is the height of irrationality.

The chief consequence of including debit card payments in the payment provisions is to disincentivize lenders from promoting or allowing such payments. Processing debit card payments is costlier to lenders than processing ACH transfers and presenting checks. As mentioned above, debit card payments are already subject to numerous restrictions, and arbitrarily placing the payment provision limitations on debit card payments creates an even heavier burden on such payments. To save on costs, lenders are likely to rely more heavily on ACH

transfers and checks, which will in turn cause consumers to incur more NSF fees. Furthermore, lenders will be more apt to charge NSF fees on ACH transfers and checks to cover the costs associated with the Final Rule. The Bureau has always promoted giving consumers as many payment options as possible, but the Final Rule works against that goal. The Final Rule should encourage the use of payment methods like debit cards, which do not result in NSF fees, rather than discourage such payments in favor of other payment methods that do.

In addition to increasing NSF fees, the Final Rule's treatment of debit card payment will also increase borrowing-related expenses for consumers. If lenders are unable to complete debit card payment transactions, the result in many cases will be for the loan to go into default. That, in itself, causes injury to the consumer's credit, increasing the likelihood that the consumer remains in the subprime credit market. Defaulted payments will result in more interest being charged on larger principal balances. Additional defaults and limited repayment options for lenders will result in significantly more collection lawsuits, which will increase the consumer's cost of credit through attorney fees, pre- and post-judgment interest, and other costs. Lenders will be forced to obtain more collection judgments resulting in disruptive wage garnishments. Thus, collection-related expenses will increase for both the lender and borrower. These can be substantial on both sides but are particularly harmful for consumers. *See, e.g.*, Comment on the Payday Rule from the Center for Responsible Lending Consumer Federation of America National Consumer Law Center, et al., at 20 (Oct. 7, 2016).

Debit card repayment is essential to the provision of longer-term and more flexible credit products that provide an alternative to single-payment balloon loans. Debit card repayment authorization facilitates longer-term loans, providing vital security for such lending. This includes installment loans, revolving loans and lines of credit, and a variety of other credit products that provide consumers with flexibility, typically lower annual percentage rates, and generally lower scheduled payments than single-payment balloon loans. Single-payment loans do not typically rely on debit card repayment and would not be impacted by the payment provision because lenders offering such loans are already required to obtain a new payment authorization for each new loan transaction.

Accordingly, one consequence of regulating debit card repayment is to increase the cost and reduce the availability of longer-term credit products and thereby channel more consumers into the very kind of single-payment balloon loans that the Bureau has identified as posing special risk of harm to consumers. Without the security of debit card repayment, longer-term lenders will be less able to extend credit to many consumers or will be forced to do so at higher rates or by charging higher fees in light of the increased risk and costs of such lending. Higher borrowing costs are, of course, detrimental to consumers.

In these respects, the Final Rule's treatment of debit card repayment is nonsensical: it purports to fix a "harm" to consumers for which there is no evidence with a solution for which there is substantial, documented evidence of

potential consumer harm. That is completely contrary to the Final Rule's stated purpose and goals.

E. The Choice of a Few Consumers To Opt in to Overdraft Protection for Debit Card Transactions Does Not Justify the Final Rule's Approach

The Final Rule's treatment of debit card payments implicitly assumes that those relatively few consumers who have affirmatively chosen to add overdraft protection to accounts accessed through debit card transactions have made a harmful decision or are likely at risk to unfair or abusive fees. That assumption is unsupported and contrary to the record. There is no risk of mounting excessive fees but rather only the "narrow circumstance" of limited overdraft fees from the consumer's bank—which the consumer affirmatively elected as a protection.

As described above, overdrafts or overdraft fees on debit card transactions are rare and permitted only when the account-holder has specifically and voluntarily authorized overdraft protection. 12 C.F.R. § 1005.17. Such consent must be affirmative, and it must be informed: regulations require a financial institution, when seeking such consent, to "[p]rovide[] the consumer with a notice in writing, or if the consumer agrees, electronically, segregated from all other information, describing the institution's overdraft service." *Id.* at § 1005.17(b)(1)(i). Moreover, the contents and form of the notice are also prescribed by regulation. *Id.* at § 1005.17(d). When account-holders consent to overdraft protection for debit card transactions, they are fully informed of the

costs and benefits of that service. And they may revoke that consent at any time, effective immediately. *Id.* at § 1005.17(f)–(g).

The evidence shows that consumers choose to opt-in to overdraft protection on debit card payments because it provides them with a safe and reputable method for accessing credit. Indeed, Professor Todd Zywicki found that "[t]here is no evidence that those who use overdraft protection are unaware of the cost or otherwise use overdraft protection foolishly or unknowingly." Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 Wash. & Lee L. Rev. 1141, 1141 (2012).

Including debit card payment in the payment provisions would require customers in certain circumstances to essentially "opt-in" a second time to take advantage of a protection they specifically and voluntarily have already chosen. The few consumers who affirmatively elect this service do so because they appreciate its benefits and expect that it will provide them the service of covering payments owed rather than defaulting on them.

In short, the Final Rule's implicit judgment on consumers' decision to opt in to overdraft protection

> runs contrary to [Former] CFPB Director Richard Cordray's own testimony to the U.S. House Financial Services Committee in March 2012 regarding the purpose and intent of the Bureau, where he stated: 'People can make their own decisions, and nobody can or should try to do that for them...[I]t is the American way for responsible businesses to be straightforward and upfront with their customers, giving them all the information they need to make informed decisions.'

Comment from Check Into Cash, Inc., *supra*, at 8.

IV. The Bureau Should Act Now

Given the lack of record support for the Final Rule's decision to include debit card payments, the strong basis to exclude them, and the harm to consumers from the Final Rule's approach, the Bureau would be well justified in reversing that decision. It should do so now, to end the uncertainty facing lenders and thereby prevent serious harm to consumers. The present record is more than adequate to conclude that the Final Rule's approach to debit card payments lacks support and imposes unjustified burdens on both lenders and consumers. That exposes the Bureau to substantial legal risk, given the lack of support for the Final Rule's arbitrary treatment of debit card payments. Thus, the Bureau should promptly modify the definition of payment transfer to exclude debit card payments.

A. The Failure to Exclude Debit Card Payments Is Harming Consumers

The Bureau has suggested that it may reconsider the Final Rule's payment provisions in the future, after it reconsiders the Rule's ability-to-pay provisions. The delay inherent in that plan, however, will cause needless harm to consumers, because the uncertainty stemming from the Final Rule's status threatens consumers now. The small change requested in this petition and comment would suffice to ameliorate much of that harm.

Lenders offering longer-term covered loans (which are disproportionally impacted by the payment provisions) face substantial uncertainty at this time. It

is difficult to evaluate the credit risks and pricing for longer-term loans when the rules to which those loans will be subject in the future are in a state of flux. That uncertainty is especially damaging because it concerns the core matter of repayment, the central source of risk in every loan. The viability of many longer-term loans turns on whether lenders will have recourse to debit card repayment in the future, as protection against default and the high costs of collection, including litigation. To be clear, the availability of debit card repayment free from the kind of regulation imposed by the Final Rule can and does often make the difference between extending credit to a consumer and denying it as too risky.

Yet lenders have no assurance at this time that they will be able to take advantage of debit card repayment for the loans that consumers are requesting today. The Final Rule, which is still on the books, severely limits the use of debit card repayment in ways that materially undermine the security necessary to extend credit. The district court's stay of the Final Rule may have been premised largely on challenges to the Rule's ability-to-pay provisions and so may or may not continue in force during and after the conclusion of the Bureau's reconsideration of those provisions. An additional reconsideration to address the Rule's payment provisions has not yet been formally announced and is uncertain with respect to its timing and focus. In the face of all these uncertainties, a prudent lender has no choice but to manage risk by limiting the availability of credit and increasing the cost of credit.

And that, in turn, causes all of the harms identified above. It denies consumers access to forms of payment that avoid NSF fees. It limits access to longer-term more flexible credit products and, as a result, increases the likelihood that consumers will be forced to resort to obtaining single-payment balloon loans. It increases consumers' borrowing costs. And it may restrict their access to credit altogether. What it does not do is reduce consumers' need for credit—that remains exactly the same, left to be satisfied in ways that involve higher costs and burdens for consumers. In this way, the present uncertainty faced by longer-term lenders exacerbates the ills that the Final Rule sought to address.

The Bureau can easily and timely put an end to this harm to consumers by implementing the change requested in this petition and comment as part of its initial reconsideration of the Final Rule. As described above, the existing rulemaking record already supports that change; the issues and evidence to be considered are manageable, given the Final Rule's lack of support for its approach; and the change goes hand-in-hand with the Bureau's reconsideration of the ability-to-pay provisions, which may reduce regulatory burdens on payday and other short-term lenders at the same time that longer-term lenders are subject to this needless uncertainty. Delaying would distort the market, by continuing disproportionate burdens on longer-term credit products. By contrast, acting now, in concert with reconsideration of the ability-to-pay provisions, would promote a level playing field across these different segments

of the consumer-lending industry at the precise time when that is especially needed.

B. Failure to Exclude Debit Cards Exposes the Bureau to Serious Litigation Risk

The Bureau faces the substantial likelihood of a legal defeat that would undermine the operation of the Final Rule if it does not exclude electronic funds transfers initiated by a debit card or prepaid card from the definition of payment transfer. This outcome would be a self-inflicted wound entirely of the Bureau's making, as the existing record not only supports but demands the exclusion of debit card transfers from the payment transfer definition. Rather than harm the consumers that the Bureau is charged with protecting and the financial services industries on which those consumers depend, and then conducting yet more rulemaking that could extend past 2020, the Bureau should exclude electronic funds transfers initiated by a debit card or prepaid card from the definition of payment transfer at Section 1041.8(a)(1). Doing so would continue to protect consumers from excessive NSF fees from the typical culprits (checks and ACH transfers) while allowing consumers the option to make more payments by debit cards and significantly reduce such fees.

As explained above in Section III, the Bureau's decision to include debit card and prepaid card transfers in the definition of payment transfer was based on portions of the record that considered the effect on consumers of ACH transfers, a different payment method that results in fees that generally do not exist for debit card and prepaid card transfers. Furthermore, that decision flies

in the face of uncontroverted empirical evidence in the record contradicting the Bureau's claim that the inclusion of debit card and prepaid card transfers was necessary for financial service providers to be able to administer the Rule. In this way, the Bureau's action was akin to the SEC that the United States Court of Appeals for the District of Columbia Circuit set aside in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

There, as here, the agency acted based "upon insufficient empirical data" that was contradicted by "numerous studies submitted by commenters that reached the opposite result." *Id.* at 1150–51. In this regard, the Final Rule's claims that excluding payments through debit cards and prepaid cards would not "alleviate much compliance burden" and could even increase compliance costs were completely unsupported and are contrary to information provided by industry and plain common sense—alternative means of collection, such as litigation, impose greater costs. Likewise, the Final Rule's bare assertions of unidentified "administrative challenges" and enforcement challenges find no record support and ignore the pervasive regulation, at the state and federal levels, of debit card networks and transactions.

Similarly, the Bureau "duck[ed] a serious evaluation of the costs" of the rule by relying on costs of ACH transfers on consumers in including debit card and prepaid card transfers in the definition. But unlike checks and ACH debits, debit card transactions generally pose no risk of overdraft or NSF fees—if the account lacks adequate funds to cover the debit, the transaction is simply denied. Only when a consumer has expressly chosen to obtain overdraft coverage is a

fee even possible, and fully two-thirds of consumers have not done so. In short, the Bureau ducked a serious evaluation of the costs and burdens of the rule on consumers and financial services provider by arbitrarily relying on other forms of payment that do not extend to debit card payments.

The likely result of the Bureau's potential failure to correct its failure to exclude debit card and prepaid card transfers would be vacatur of the definition of payment transfer at Section 1041.8(a)(1). Not only is vacatur the presumptive remedy for arbitrary and capricious agency action, *see Sierra Club v. Van Antwerp*, 719 F. Supp. 2d 77, 78 (D.D.C. 2010) (collecting cases), but that presumption is reinforced where, as in this case, the agency will be unable to justify maintaining the inclusion of debit card and prepaid cards in the payment transfer definition on remand, *see Fox Television Stations, Inc. v. Fed. Comms. Comm'n*, 280 F.3d 1027, 1052–53 (D.C. Cir. 2002).

Vacatur of the payment transfer definition would lead to substantial uncertainty in administering the Final Rule, even as amended through reconsideration. The term "payment transfer" is one of the backbone definitions of the Final Rule and is used frequently throughout, including in Sections 1041.3, 1041.8, 1041.9, and 1041.12. Each of these mechanisms would be placed in jeopardy with vacatur and could require substantial effort on the part of the Bureau to address on remand. Depending on the timeframe for litigation and the potential necessity of additional notice and comment on remand, such proceedings may not be completed until after 2020. Even if the definition of payment transfer were partially vacated only to the extent it failed to exclude

debit cards and prepaid cards, the possibility of remand proceedings after 2020 exist.

In addition to these legal problems for the Bureau, the interim period between finalization of a reconsideration proceeding that failed to exclude debit cards and prepaid cards would exacerbate the already substantial uncertainty in the marketplace that would exist if the Bureau declines to modify this definition. The mere fact of delay in fixing the failure to exclude prepaid cards and debit cards from the definition of payment transfers could cause those same financial services providers potentially moving towards less consumer- friendly financial products and payment methods, and it is far from certain that they would return to their traditional offerings with a later fix. This uncertainty would harm both consumers and financial service providers for the reasons discussed above.

Finally, this Rule is the Bureau's inaugural exercise of authority under Section 1031, and because it will set precedent for the future, "it is critical that, in any final rule, the Bureau identify unfair or abusive acts only for which it has evidence establishing the unfairness or abusiveness of the act. The Bureau has not met that standard in the proposed rule with respect to small dollar installment loans, single payment loans, and lines of credit offered by banks." American Bankers Association Comment on the Proposed Rule at 6 (Oct. 7, 2016). Given that no additional research or analysis is required to conclude that the Final Rule's approach lacks support and imposes unjustified burdens on both lenders and consumers, as this conclusion can be made on the existing record,

any failure to revisit inclusion of debit cards and prepaid cards from the payment transfer definition would be a problem of the Bureau's own making.

V. Rulemaking Request

The Bureau should modify the definition of payment transfer to clarify that a transfer initiated through a debit card or a prepaid card is not included. To make the change, the Bureau should simply insert the following paragraph in Section 1041.8(a)(1):

> (iii) Exclusion for certain transfers. An electronic funds transfer initiated by a debit card or a prepaid card is not a payment transfer, notwithstanding that the transfer otherwise meets the description in paragraph (a)(1) of this section.

Respectfully submitted,

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Counsel to Advance Financial

TAB 3

cfpb Consumer Financial Protection Bureau

UPDATED SEP 13, 2017

What is the Total Interest Percentage (TIP) on a mortgage?

The Total Interest Percentage (TIP) is a disclosure that tells you how much interest you will pay over the life of your mortgage loan.

You can find the TIP for your loan on page 3 of your Loan Estimate or page 5 of your Closing Disclosure. The TIP is most useful as a comparison point between different Loan Estimates.

The TIP tells you how much interest you will pay over the life of your mortgage loan, compared to the amount you borrowed. The total interest percentage is calculated by adding up all of the scheduled interest payments, then dividing the total by the loan amount to get a percentage. The calculation assumes that you will make all your payments as scheduled. The calculation also assumes that you will keep the loan for the entire loan term.

For example, if you have a $100,000 loan and your TIP is 50 percent, that means you will pay a total of $50,000 in interest over the life of the loan, in addition to repaying the $100,000 that you borrowed. If your TIP is 100 percent, that means you will pay $100,000 in interest (100 percent of the $100,000 loan amount) over the life of the loan.

If your Loan Estimate is for an adjustable-rate mortgage (ARM), the TIP is calculated using current interest rates. The actual amount you pay could be more or less, depending on how rates change in the future.

The TIP is not the same as your interest rate, and it is not the same as the annual percentage rate (APR). The TIP will usually be much larger than either the interest rate or the APR. This is because the TIP is based on the total interest you would pay over the full term of the mortgage, while the interest rate and APR are annual rates. A $100,000 loan with a 4 percent fixed interest rate, for example, could have an APR

of 4.25 percent and a TIP of 72 percent. Both numbers tell you something useful about what you will pay.

Tip: The TIP does not include upfront fees, other than prepaid interest. One loan may have a lower TIP but higher fees than another loan. The APR, by contrast, includes upfront fees. Make sure to consider all the costs before choosing a loan.

Don't see what you're looking for?

Browse related questions

What is a Closing Disclosure?

On a mortgage, what's the difference between my principal and interest payment and my total monthly payment?

What does "total of payments" mean when getting a mortgage?

Learn more about mortgages

Search for your question

Search

Was this answer helpful to you?

Yes No

Additional Information About This Loan

LENDER	Ficus Bank	MORTGAGE BROKER	
NMLS/__ LICENSE ID		NMLS/__ LICENSE ID	
LOAN OFFICER	Joe Smith	LOAN OFFICER	
NMLS/__ LICENSE ID	12345	NMLS/__ LICENSE ID	
EMAIL	joesmith@ficusbank.com	EMAIL	
PHONE	123-456-7890	PHONE	

Comparisons

Use these measures to compare this loan with other loans.

In 5 Years	$56,582	Total you will have paid in principal, interest, mortgage insurance, and loan costs.
	$15,773	Principal you will have paid off.
Annual Percentage Rate (APR)	4.274%	Your costs over the loan term expressed as a rate. This is not your interest rate.
Total Interest Percentage (TIP)	69.45%	The total amount of interest that you will pay over the loan term as a percentage of your loan amount.

Other Considerations

Appraisal
We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost.

Assumption
If you sell or transfer this property to another person, we
☐ will allow, under certain conditions, this person to assume this loan on the original terms.
☒ will not allow assumption of this loan on the original terms.

Homeowner's Insurance
This loan requires homeowner's insurance on the property, which you may obtain from a company of your choice that we find acceptable.

Late Payment
If your payment is more than *15* days late, we will charge a late fee of *5% of the monthly principal and interest payment.*

Refinance
Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.

Servicing
We intend
☐ to service your loan. If so, you will make your payments to us.
☒ to transfer servicing of your loan.

Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

Applicant Signature _____ Date _____ Co-Applicant Signature _____ Date _____

TAB 4

Syllabus

SUPREME COURT OF THE UNITED STATES

Syllabus

HENRY SCHEIN, INC., ET AL. *v.* ARCHER & WHITE SALES, INC.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 17–1272. Argued October 29, 2018—Decided January 8, 2019

Respondent Archer & White Sales, Inc., sued petitioner Henry Schein, Inc., alleging violations of federal and state antitrust law and seeking both money damages and injunctive relief. The relevant contract between the parties provided for arbitration of any dispute arising under or related to the agreement, except for, among other things, actions seeking injunctive relief. Invoking the Federal Arbitration Act, Schein asked the District Court to refer the matter to arbitration, but Archer & White argued that the dispute was not subject to arbitration because its complaint sought injunctive relief, at least in part. Schein contended that because the rules governing the contract provide that arbitrators have the power to resolve arbitrability questions, an arbitrator—not the court—should decide whether the arbitration agreement applied. Archer & White countered that Schein's argument for arbitration was wholly groundless, so the District Court could resolve the threshold arbitrability question. The District Court agreed with Archer & White and denied Schein's motion to compel arbitration. The Fifth Circuit affirmed.

Held: The "wholly groundless" exception to arbitrability is inconsistent with the Federal Arbitration Act and this Court's precedent. Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U. S. 63, 67. The parties to such a contract may agree to have an arbitrator decide not only the merits of a particular dispute, but also "'gateway' questions of 'arbitrability.'" *Id.*, at 68–69. Therefore, when the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless.

That conclusion follows also from this Court's precedent. See *AT&T Technologies, Inc.* v. *Communications Workers*, 475 U. S. 643, 649–650.

Archer & White's counterarguments are unpersuasive. First, its argument that §§3 and 4 of the Act should be interpreted to mean that a court must always resolve questions of arbitrability has already been addressed and rejected by this Court. See, *e.g.*, *First Options of Chicago, Inc.* v. *Kaplan*, 514 U. S. 938, 944. Second, its argument that §10 of the Act—which provides for back-end judicial review of an arbitrator's decision if an arbitrator has "exceeded" his or her "powers"—supports the conclusion that the court at the front end should also be able to say that the underlying issue is not arbitrable is inconsistent with the way Congress designed the Act. And it is not this Court's proper role to redesign the Act. Third, its argument that it would be a waste of the parties' time and money to send wholly groundless arbitrability questions to an arbitrator ignores the fact that the Act contains no "wholly groundless" exception. This Court may not engraft its own exceptions onto the statutory text. Nor is it likely that the exception would save time and money systemically even if it might do so in some individual cases. Fourth, its argument that the exception is necessary to deter frivolous motions to compel arbitration overstates the potential problem. Arbitrators are already capable of efficiently disposing of frivolous cases and deterring frivolous motions, and such motions do not appear to have caused a substantial problem in those Circuits that have not recognized a "wholly groundless" exception.

The Fifth Circuit may address the question whether the contract at issue in fact delegated the arbitrability question to an arbitrator, as well as other properly preserved arguments, on remand. Pp. 4–8.

878 F. 3d 488, vacated and remanded.

KAVANAUGH, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 17–1272

HENRY SCHEIN, INC., ET AL., PETITIONERS *v.* ARCHER AND WHITE SALES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

[January 8, 2019]

JUSTICE KAVANAUGH delivered the opinion of the Court.

Under the Federal Arbitration Act, parties to a contract may agree that an arbitrator rather than a court will resolve disputes arising out of the contract. When a dispute arises, the parties sometimes may disagree not only about the merits of the dispute but also about the threshold arbitrability question—that is, whether their arbitration agreement applies to the particular dispute. Who decides that threshold arbitrability question? Under the Act and this Court's cases, the question of who decides arbitrability is itself a question of contract. The Act allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes. *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U. S. 63, 68–70 (2010); *First Options of Chicago, Inc.* v. *Kaplan*, 514 U. S. 938, 943–944 (1995).

Even when a contract delegates the arbitrability question to an arbitrator, some federal courts nonetheless will short-circuit the process and decide the arbitrability question themselves if the argument that the arbitration agreement applies to the particular dispute is "wholly

groundless." The question presented in this case is whether the "wholly groundless" exception is consistent with the Federal Arbitration Act. We conclude that it is not. The Act does not contain a "wholly groundless" exception, and we are not at liberty to rewrite the statute passed by Congress and signed by the President. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract. We vacate the contrary judgment of the Court of Appeals.

I

Archer and White is a small business that distributes dental equipment. Archer and White entered into a contract with Pelton and Crane, a dental equipment manufacturer, to distribute Pelton and Crane's equipment. The relationship eventually soured. As relevant here, Archer and White sued Pelton and Crane's successor-in-interest and Henry Schein, Inc. (collectively, Schein) in Federal District Court in Texas. Archer and White's complaint alleged violations of federal and state antitrust law, and sought both money damages and injunctive relief.

The relevant contract between the parties provided:

> "Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina." App. to Pet. for Cert. 3a.

After Archer and White sued, Schein invoked the Federal Arbitration Act and asked the District Court to refer the

parties' antitrust dispute to arbitration. Archer and White objected, arguing that the dispute was not subject to arbitration because Archer and White's complaint sought injunctive relief, at least in part. According to Archer and White, the parties' contract barred arbitration of disputes when the plaintiff sought injunctive relief, even if only in part.

The question then became: Who decides whether the antitrust dispute is subject to arbitration? The rules of the American Arbitration Association provide that arbitrators have the power to resolve arbitrability questions. Schein contended that the contract's express incorporation of the American Arbitration Association's rules meant that an arbitrator—not the court—had to decide whether the arbitration agreement applied to this particular dispute. Archer and White responded that in cases where the defendant's argument for arbitration is wholly groundless—as Archer and White argued was the case here—the District Court itself may resolve the threshold question of arbitrability.

Relying on Fifth Circuit precedent, the District Court agreed with Archer and White about the existence of a "wholly groundless" exception, and ruled that Schein's argument for arbitration was wholly groundless. The District Court therefore denied Schein's motion to compel arbitration. The Fifth Circuit affirmed.

In light of disagreement in the Courts of Appeals over whether the "wholly groundless" exception is consistent with the Federal Arbitration Act, we granted certiorari, 585 U. S. ___ (2018). Compare 878 F. 3d 488 (CA5 2017) (case below); *Simply Wireless, Inc.* v. *T-Mobile US, Inc.*, 877 F. 3d 522 (CA4 2017); *Douglas* v. *Regions Bank*, 757 F. 3d 460 (CA5 2014); *Turi* v. *Main Street Adoption Servs., LLP*, 633 F. 3d 496 (CA6 2011); *Qualcomm, Inc.* v. *Nokia Corp.*, 466 F. 3d 1366 (CA Fed. 2006), with *Belnap* v. *Iasis Healthcare*, 844 F. 3d 1272 (CA10 2017); *Jones* v. *Waffle*

House, Inc., 866 F. 3d 1257 (CA11 2017); *Douglas*, 757 F. 3d, at 464 (Dennis, J., dissenting).

II

In 1925, Congress passed and President Coolidge signed the Federal Arbitration Act. As relevant here, the Act provides:

> "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U. S. C. §2.

Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. *Rent-A-Center,* 561 U. S., at 67. Applying the Act, we have held that parties may agree to have an arbitrator decide not only the merits of a particular dispute but also "'gateway' questions of 'arbitrability,' such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy." *Id.,* at 68–69; see also *First Options*, 514 U. S., at 943. We have explained that an "agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce, and the FAA operates on this additional arbitration agreement just as it does on any other." *Rent-A-Center*, 561 U. S., at 70.

Even when the parties' contract delegates the threshold arbitrability question to an arbitrator, the Fifth Circuit and some other Courts of Appeals have determined that the court rather than an arbitrator should decide the threshold arbitrability question if, under the contract, the argument for arbitration is wholly groundless. Those courts have reasoned that the "wholly groundless" excep-

tion enables courts to block frivolous attempts to transfer disputes from the court system to arbitration.

We conclude that the "wholly groundless" exception is inconsistent with the text of the Act and with our precedent.

We must interpret the Act as written, and the Act in turn requires that we interpret the contract as written. When the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract. In those circumstances, a court possesses no power to decide the arbitrability issue. That is true even if the court thinks that the argument that the arbitration agreement applies to a particular dispute is wholly groundless.

That conclusion follows not only from the text of the Act but also from precedent. We have held that a court may not "rule on the potential merits of the underlying" claim that is assigned by contract to an arbitrator, "even if it appears to the court to be frivolous." *AT&T Technologies, Inc.* v. *Communications Workers*, 475 U. S. 643, 649–650 (1986). A court has "'no business weighing the merits of the grievance'" because the "'agreement is to submit all grievances to arbitration, not merely those which the court will deem meritorious.'" *Id.,* at 650 (quoting *Steelworkers* v. *American Mfg. Co.*, 363 U. S. 564, 568 (1960)).

That *AT&T Technologies* principle applies with equal force to the threshold issue of arbitrability. Just as a court may not decide a merits question that the parties have delegated to an arbitrator, a court may not decide an arbitrability question that the parties have delegated to an arbitrator.

In an attempt to overcome the statutory text and this Court's cases, Archer and White advances four main arguments. None is persuasive.

First, Archer and White points to §§3 and 4 of the Federal Arbitration Act. Section 3 provides that a court must

stay litigation "upon being satisfied that the issue" is "referable to arbitration" under the "agreement." Section 4 says that a court, in response to a motion by an aggrieved party, must compel arbitration "in accordance with the terms of the agreement" when the court is "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue."

Archer and White interprets those provisions to mean, in essence, that a court must always resolve questions of arbitrability and that an arbitrator never may do so. But that ship has sailed. This Court has consistently held that parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties' agreement does so by "clear and unmistakable" evidence. *First Options*, 514 U. S., at 944 (alterations omitted); see also *Rent-A-Center*, 561 U. S., at 69, n. 1. To be sure, before referring a dispute to an arbitrator, the court determines whether a valid arbitration agreement exists. See 9 U. S. C. §2. But if a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue.

Second, Archer and White cites §10 of the Act, which provides for back-end judicial review of an arbitrator's decision if an arbitrator has "exceeded" his or her "powers." §10(a)(4). According to Archer and White, if a court at the back end can say that the underlying issue was not arbitrable, the court at the front end should also be able to say that the underlying issue is not arbitrable. The dispositive answer to Archer and White's §10 argument is that Congress designed the Act in a specific way, and it is not our proper role to redesign the statute. Archer and White's §10 argument would mean, moreover, that courts presumably also should decide frivolous merits questions that have been delegated to an arbitrator. Yet we have already rejected that argument: When the parties' contract assigns a matter to arbitration, a court may not

resolve the merits of the dispute even if the court thinks that a party's claim on the merits is frivolous. *AT&T Technologies*, 475 U. S., at 649–650. So, too, with arbitrability.

Third, Archer and White says that, as a practical and policy matter, it would be a waste of the parties' time and money to send the arbitrability question to an arbitrator if the argument for arbitration is wholly groundless. In cases like this, as Archer and White sees it, the arbitrator will inevitably conclude that the dispute is not arbitrable and then send the case back to the district court. So why waste the time and money? The short answer is that the Act contains no "wholly groundless" exception, and we may not engraft our own exceptions onto the statutory text. See *Exxon Mobil Corp.* v. *Allapattah Services, Inc.*, 545 U. S. 546, 556–557 (2005).

In addition, contrary to Archer and White's claim, it is doubtful that the "wholly groundless" exception would save time and money systemically even if it might do so in some individual cases. Archer and White assumes that it is easy to tell when an argument for arbitration of a particular dispute is wholly groundless. We are dubious. The exception would inevitably spark collateral litigation (with briefing, argument, and opinion writing) over whether a seemingly unmeritorious argument for arbitration is *wholly* groundless, as opposed to groundless. We see no reason to create such a time-consuming sideshow.

Archer and White further assumes that an arbitrator would inevitably reject arbitration in those cases where a judge would conclude that the argument for arbitration is wholly groundless. Not always. After all, an arbitrator might hold a different view of the arbitrability issue than a court does, even if the court finds the answer obvious. It is not unheard-of for one fair-minded adjudicator to think a decision is obvious in one direction but for another fair-minded adjudicator to decide the matter the other way.

Fourth, Archer and White asserts another policy argument: that the "wholly groundless" exception is necessary to deter frivolous motions to compel arbitration. Again, we may not rewrite the statute simply to accommodate that policy concern. In any event, Archer and White overstates the potential problem. Arbitrators can efficiently dispose of frivolous cases by quickly ruling that a claim is not in fact arbitrable. And under certain circumstances, arbitrators may be able to respond to frivolous arguments for arbitration by imposing fee-shifting and cost-shifting sanctions, which in turn will help deter and remedy frivolous motions to compel arbitration. We are not aware that frivolous motions to compel arbitration have caused a substantial problem in those Circuits that have not recognized a "wholly groundless" exception.

In sum, we reject the "wholly groundless" exception. The exception is inconsistent with the statutory text and with our precedent. It confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract.

We express no view about whether the contract at issue in this case in fact delegated the arbitrability question to an arbitrator. The Court of Appeals did not decide that issue. Under our cases, courts "should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so." *First Options,* 514 U. S., at 944 (alterations omitted). On remand, the Court of Appeals may address that issue in the first instance, as well as other arguments that Archer and White has properly preserved.

The judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

TAB 6

116TH CONGRESS
1ST SESSION

H. R. 5050

To amend the Truth in Lending Act to extend the consumer credit protections provided to members of the Armed Forces and their dependents under title 10, United States Code, to all consumers.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 12, 2019

Mr. GARCÍA of Illinois (for himself, Mr. GROTHMAN, Ms. GARCIA of Texas, and Mr. GREEN of Texas) introduced the following bill; which was referred to the Committee on Financial Services

---

A BILL

To amend the Truth in Lending Act to extend the consumer credit protections provided to members of the Armed Forces and their dependents under title 10, United States Code, to all consumers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Veterans and Consumers Fair Credit Act".

1 **SEC. 2. LIMITATIONS ON CONSUMER CREDIT AND MAX-**
2 **IMUM RATES OF INTEREST.**

3 (a) IN GENERAL.—Chapter 2 of the Truth in Lend-
4 ing Act (15 U.S.C. 1631 et seq.) is amended by adding
5 at the end the following:

6 **"§ 140B. Limitations on consumer credit and max-**
7 **imum rates of interest**

8 "(a) APPLICATION OF THE MILITARY LENDING
9 ACT.—

10 "(1) IN GENERAL.—Except as provided in para-
11 graph (2), section 987(b) of title 10, United States
12 Code (commonly referred to as the 'Military Lending
13 Act'), shall apply to a creditor who extends con-
14 sumer credit to a consumer to the same extent as
15 such section applies to a creditor who extends con-
16 sumer credit to a covered member or a dependent
17 with respect to a covered member (as those terms
18 are defined in such section 987).

19 "(2) EXCEPTIONS.—Paragraph (1) shall not
20 apply to—

21 "(A) a residential mortgage;

22 "(B) a loan procured in the course of pur-
23 chasing a car or other personal property, when
24 that loan is offered for the express purpose of
25 financing the purchase and is secured by the
26 car or personal property procured; or

"(C) a loan made by a Federal credit union, as that term is defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752), subject to the usury limit provided under section 107(5)(A) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)), as implemented by the National Credit Union Administration Board.

"(b) NO EXEMPTIONS PERMITTED.—The exemption authority of the Bureau under section 105(f) shall not apply with respect to this section.

"(c) CALCULATION OF THE ANNUAL PERCENTAGE RATE FOR OPEN-END CREDIT.—

"(1) IN GENERAL.—For purposes of this section, the annual percentage rate applicable to an open end credit plan shall be calculated under section 107(a)(2), subject to adjustments to the amount considered a finance charge, as provided in the rules issued by the Secretary of Defense on July 22, 2015, to carry out section 987 of title 10, United States Code.

"(2) EXCEPTION TO FINANCE CHARGE CALCULATION.—

"(A) IN GENERAL.—Notwithstanding paragraph (1), for consumer credit extended in a

1 credit card account under an open end (not
2 home-secured) consumer credit plan, a bona
3 fide fee other than a periodic rate is not a
4 charge required to be included within the fi-
5 nance charge for purposes of this section if the
6 fee is assessed in compliance with section
7 127(n).

8 "(B) LIMITATION.—Subparagraph (A)
9 shall not apply to—

10 "(i) any credit insurance premium or
11 fee, including any charge for single pre-
12 mium credit insurance, any fee for a debt
13 cancellation contract, or any fee for a debt
14 suspension agreement; or

15 "(ii) any fee for a credit-related ancil-
16 lary product sold in connection with the
17 credit card account under an open-end (not
18 home-secured) consumer credit plan.

19 "(d) RELATION TO STATE LAW.—Nothing in this
20 section may be construed to preempt any provision of
21 State law that provides greater protection to consumers
22 than is provided under this section.

23 "(e) PENALTIES AND REMEDIES.—Section 987(f) of
24 title 10, United States Code, shall apply to a creditor who
25 extends consumer credit to a consumer in violation of this

1 section to the same extent as such section 987(f) applies
2 to a creditor who extends consumer credit to a covered
3 member or a dependent with respect to a covered member
4 (as those terms are defined in such section 987).

5 "(f) PRESERVATION OF STATE ENFORCEMENT.—

6 "(1) STATE ATTORNEYS GENERAL.—Not later
7 than 3 years after the date on which a violation of
8 this section occurs, the attorney general of a State
9 (or an equivalent official) may bring a civil action in
10 the name of that State—

11 "(A) in any district court of the United
12 States that is located in that State or in a
13 State court that is located in that State and
14 that has jurisdiction over the defendant; and

15 "(B) to—

16 "(i) enforce provisions of this section
17 or rules issued under this section; and

18 "(ii) secure remedies under provisions
19 of this section or remedies otherwise pro-
20 vided under other law.

21 "(2) STATE REGULATORS.—Not later than 3
22 years after the date on which a violation of this sec-
23 tion occurs, a State regulator may bring a civil ac-
24 tion or initiate another appropriate proceeding to—

"(A) enforce the provisions of this section or regulations issued under this section with respect to any entity that is, or is required to be, State-chartered, incorporated, licensed, or otherwise authorized to do business under State law; and

"(B) secure remedies under provisions of this section or remedies otherwise provided under other provisions of law with respect to an entity described in subparagraph (A).

"(3) NOTICE REQUIREMENT; ADDITIONAL REGULATIONS.—Subsections (b), (c), and (d) of section 1042 of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5552), shall apply to a civil action or other appropriate proceeding brought or initiated under paragraph (1) or (2) to the same extent as those subsections apply to actions and other administrative and regulatory proceedings described in subsection (a) of such section 1042.

"(g) REGULATIONS.—

"(1) IN GENERAL.—Notwithstanding section 1027(o) of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5517(o)), not later than 1 year after the date of enactment of this section, the Bu-

1 reau, in consultation with the Secretary of Defense,
2 shall—
3 "(A) issue rules carrying out this section;
4 and
5 "(B) notify Congress and the public, in-
6 cluding on the website of the Bureau, regarding
7 the issuance of the rules required under sub-
8 paragraph (A).
9 "(2) CONSISTENCY.—The rules issued by the
10 Bureau under paragraph (1)—
11 "(A) shall be consistent with rules issued
12 by the Secretary of Defense to carry out section
13 987 of title 10, United States Code; and
14 "(B) may not provide lesser protection to
15 consumers than the protection afforded covered
16 members, as that term is defined in section 987
17 of title 10, United States Code, in applicable
18 provisions in the rules issued by the Secretary
19 of Defense on July 22, 2015, to carry out such
20 section 987.".
21 (b) CLERICAL AMENDMENT.—The table of contents
22 for chapter 2 of the Truth in Lending Act is amended
23 by adding at the end the following:

"140B. Limitations on consumer credit and maximum rates of interest.".

1 (c) APPLICABILITY.—The amendments made by sub-
2 section (a) shall apply to an extension of credit made after
3 the earlier of—
4 (1) the date on which the rules issued by the
5 Bureau of Consumer Financial Protection under
6 subsection (g) of section 140B of the Truth in Lend-
7 ing Act, as added by subsection (a) of this section,
8 require compliance; and
9 (2) the date that is 18 months after the date
10 of enactment of this Act.

○

Document No. 8974

ORDINANCE NO. 11182

AN ORDINANCE AMENDING CHAPTER 7, 'BUSINESSES AND OCCUPATIONS GENERALLY' BY ADDING ARTICLE V, 'SHORT-TERM LENDING CODE' AND AMENDING CHAPTER 30, 'UNIFIED DEVELOPMENT ORDINANCE', SECTION 20-25.5, 'SPECIAL USE PERMITS', OF THE CODE OF THE CITY OF LIBERTY, CLAY COUNTY, MISSOURI

WHEREAS, City Council concludes that the lending and marketing practices of Short-Term Loan Establishments, as defined herein, result in serious financial hardships to some of its citizens, particularly its elderly and low-income citizens, from which they cannot readily extract themselves; can perpetuate poverty; and can increase dependency upon public financial assistance, housing, health care, and social services; and

WHEREAS, City Council finds that the short-term loan industry targets low-income citizens, who are most likely to suffer financial hardship as a result of the lending practices and small loan products offered by Short-Term Loan Establishments; and

WHEREAS, City Council recognizes that the State of Missouri regulates Short-Term Loan Establishments in certain regards but further recognizes that those State regulations do not meet the level of protections for consumers common in adjacent states, nor do they adequately protect the City's citizens from certain lending and marketing practices of Short-Term Loan Establishments; and

WHEREAS, the City has the authority to further regulate Short-Term Loan Establishments in the manner described below; and

WHEREAS, City Council finds that regulation of Short-Term Loan Establishments is necessary for the promotion and protection of the public health, safety, and welfare of its citizens, and the public good of maintaining a viable tax base to fund essential services.

WHEREAS, a citizen initiative petition was received on April 18, 2019 to amend the City Code pertaining to Payday Loan and Title Loan Businesses in Liberty, and the Clay County Board of Election Commissioners verified that the petition contained 1,270 valid signatures and therefore met the requirement set out in RSMO 78.200. The Deputy City Clerk verified that it was a valid petition on July 12, 2019 and brought it forward for Council consideration; and

WHEREAS, pursuant to Ordinance No. 11125 on July 22, 2019, and in accordance with the Revised Statutes of Missouri, as amended, the City Council called

an election on a Question of adding a Short-Term Lending Code and $5,000.00 Permit Fee to the City Code, of the City of Liberty, Clay County Missouri, and such ballot was submitted to the qualified voters of the City on November 5, 2019, at the general election held on such date; and

WHEREAS, a majority of the votes case on the question by the qualified voters voting thereon were in favor of the question, and the election authority has provided the City with a certified copy of the election results, a copy of which is attached hereto as Exhibit A and is incorporated herein by reference; and

WHEREAS, the Council has determined that the qualified voters of the City have taken all actions necessary to authorize the Council to enact a Short-Term Lending Code and impose the permit fee, and the Council therefore now wishes to amend the Municipal Code of the City of Liberty accordingly;

BE IT ORDAINED by the City Council of the City of Liberty, Clay County, Missouri as follows:

SECTION I

Article V is hereby added to Chapter 7, 'Businesses and Occupations Generally', of the City Code of the City of Liberty as follows, and shall be known as the 'Short-Term Lending Code.'

ARTICLE V. – SHORT-TERM LENDING CODE

Sec. 7-30. - Definitions.

The following words, when used in the Short-Term Lending Code, shall have the meanings ascribed to them in this section, except where the context clearly indicates a different meaning:

Director means the Director of the Department of Finance of the City or a person designated by the Director of the Department of Finance.

Permittee means any individual, firm, association, corporation, partnership, association or organization holding a permit issued by the Director pursuant to the Short-Term Lending Code to operate a Short-Term Loan Establishment.

Premises means the bounds of the facility where a Short-Term Loan Establishment conducts business and includes parking lots and other adjacent private property occupied by or used in connection with the business.

Short-Term Loan Establishment means an establishment which: (a) engages in the business of providing money to customers on a temporary basis,

wherein such loans are secured by post-dated check, paycheck, or car title, (b) provides an extension of credit made at an Annual Percentage Rate (as defined in accordance with federal law) in excess of 45%, or (c) is registered as a lender under state or federal law. This classification does not include a state or federally chartered bank, savings and loan association, credit union, or mortgage broker or originator. This classification does not include nonprofit organizations exempt from taxes under Section 501(c)(3) of the Internal Revenue Code of 1986 as amended, nor does it include organizations certified as Community Development Financial Institutions by the U.S. Treasury. Further, this classification does not include the businesses of licensed pawnbrokers or establishments selling consumer goods, including consumables, where the loans or the cashing of checks or money orders are incidental to the main purpose of the business. This classification does include, but is not limited to, check cashing stores, payday loan stores, and car title loan businesses.

Sec. 7-31. – Applicability of other regulations; conflicting provisions.

(a) In the event of a conflict between the provisions of the Short-Term Lending Code and other ordinances or other parts of the Liberty City Code, the provisions of the Short-Term Lending Code shall control.

(a) The permit and fees required by the Short-Term Lending Code shall be in addition to any other licenses, permits, and fees required by the Liberty City Code.

(b) The permit fees required by the Short-Term Lending Code are intended to defray the costs of investigating and processing the applications for the permits, of any enforcement efforts required by the Short-Term Lending Code, and costs to the public for the economic damage associated with short term loans.

(c) Short-Term Loan Establishments are subject to zoning conditions and restrictions, including issuance of a Special Use Permit as outlined in Chapter 30, Unified Development Ordinance, Section 30-25.5 Special Use Permits, uses to be considered.

Sec. 7-32. – Short-Term Loan Establishment Permit required.

Within sixty (60) days of the effective date of this Ordinance, it shall be unlawful for any individual, firm, association, corporation, partnership, or organization:

(a) To operate or maintain a Short-Term Loan Establishment in the City unless the owner, operator, or lessee thereof has applied for

and obtained a Short-Term Loan Establishment permit from the City; or

(b) To operate such business after such permit has expired or has been revoked by the City.

A permit shall be required for each location at which a Short-Term Loan Establishment operates in the City; even a location within another business operation. A permit shall be valid for a period of time of one calendar year (or the remaining portion of a calendar year) and must be renewed annually. This permit shall be in addition to any other permit or license required by other local, state, or federal government. No permit shall be issued for any business seeking to operate at a location prohibited by any applicable local, state, or federal law, statute, ordinance, rule or regulation; provided, however, that a business lawfully in existence on the date of adoption of the Short-Term Lending Code is eligible to apply for and receive a permit so long as such business is otherwise compliant with all laws.

Sec. 7-33. – Short-Term Loan Establishment Permit duration; renewal; fees.

(a) Permits for the operation of a Short-Term Loan Establishment shall be annual permits which expire on December 31 of each year. Each permit shall include the name of the permit holder and address of the premises. Permits in good standing on the date of their expiration shall be eligible for renewal. The application for a permit shall be accompanied by payment in full of the fee stated in this section, by cash, certified or cashier's check, or money order. No application shall be considered complete until the fee is paid. The fee shall not be refunded under any circumstances.

(b) The fee for each permit shall be as follows: Short-Term Loan Establishment permit fee all existing and new applicants shall be $5,000 per year, or $2,500 if less than six (6) months remain in the calendar year on the date a permit is issued.

(c) No fees will be effective until approved by a simple majority of the City's electors.

Sec. 7-34. – Compliance with Code.

Any violation of the Building Code, Fire Prevention Code, or the Zoning Ordinance shall be a basis to deny, revoke, or not renew a Short-Term Loan Establishment permit.

Sec. 7-35. – Authority to prescribe additional regulations.

The Director shall have the power to promulgate regulations as may be necessary and feasible for carrying out of the intent of the Short-Term Lending Code and the duties of the Director under the Short-Term Lending Code which are not inconsistent with the provisions of such Code.

Sec. 7-36. – Penalty for violation of Short-Term Lending Code.

It shall be unlawful for any person to violate any of the provisions of the Short-Term Lending Code. Upon conviction thereof, such person shall be fined not less than $100 and not more than $500. Each day's violation of, or failure, refusal, or neglect to comply with any provision of the Short-Term Lending Code shall constitute a separate and distinct offense. The penalties provided in this section are in addition to, and are separate from, any administrative actions by the Director to revoke or deny renewal of a permit issued under the Short-Term Lending Code.

Sec. 7-37. - Administrative actions to revoke or deny renewal of a permit.

Any permittee licensed pursuant to the Short-Term Lending Code who fails, refuses or neglects to comply with the provisions of this section, or any laws relating to consumer loans or commits any criminal act may have its permit suspended or revoked by the Director after a hearing before the Director on an order of the Director to show cause why such order of suspension or revocation should not be entered specifying the grounds therefor which shall be served on the licensee at least ten days prior to the hearing.

Whenever it shall appear to the Director that any permittee is failing, refusing or neglecting to make a good faith effort to comply with the provisions of this Short-Term Lending Code, or any laws relating to consumer loans, the Director may issue an order to cease and desist which order may be enforceable by sec. 7-36, penalty for violation of short-term lending code, for each day that the neglect, failure or refusal shall continue.

Sec. 7-38. – Judicial review of orders of Director; stay of enforcement of orders.

Following the entry of an order by the Director revoking a permit or denying a new or renewal application for a permit, such permittee or applicant may seek judicial review in a manner provided by law. The Director shall stay enforcement of such order for a period of time not to exceed 30 days from the Director's decision or, if a petition for judicial review is filed, final disposition of the judicial review.

Sec. 7-39. – Contents of application.

Any person desiring to operate a Short-Term Loan Establishment shall make written application for a Short-Term Loan Establishment permit or the

renewal thereof to the Director or the Director's designee. The application shall be signed by the applicant or an authorized signator of the applicant and notarized. All applications shall be submitted on a form supplied by the Director and shall set forth at least the following:

(a) The name, residence address, electronic mail address, home and cellular telephone number, and date and place of birth of the applicant or authorized signator;

(b) The business name, street address of the business premises, electronic mail address of the business, and telephone number of the business;

(c) The names, residence addresses, residence and cellular telephone numbers, and dates and places of birth of the following:

(1) All partners, if the applicant is a partnership;

(2) All members, if the applicant is a limited liability company;

(3) All corporate officers and Directors and all shareholders with greater than a 10 percent (10%) interest in the corporation, if the applicant is a corporation; and

(d) Whether or not the applicant and/or authorized signator has been convicted of violating any provision of the Short-Term Lending Code; has been convicted of a felony, misdemeanor, infraction or ordinance violation involving moral turpitude, a breach of a fiduciary obligation, or crimes of physical violence or against property; or has ever had a permit issued under the Short-Term Lending Code revoked and, if so, the reason therefore;

(e) If the applicant is a Missouri corporation, a certificate of good standing issued by the Missouri secretary of state not more than 30 days prior to the submittal of the application or, if a foreign corporation, a certificate of authority to do business issued by the Missouri secretary of state not more than 30 days prior to the submittal of the application; and

(f) Such further information as the Director may reasonably require.

Sec. 7-40. – Criteria for issuance of permit.

The Director shall investigate the application for a Short-Term Loan Establishment permit and shall issue the permit authorized by the Short-Term Lending Code if the Director finds that each of the following conditions is met

without exception:

(a) Applicant is current in the payment of all taxes, fees, and other amounts due to the City on any account, for any purpose;

(b) The application appears to be truthful, complete, and accurate;

(c) The application is accompanied by the required fee;

(d) The location of the premises meets all applicable spacing, distance and location requirements of the Short-Term Lending Code and applicable zoning ordinances, or the Establishment was lawfully in existence on the date of adoption of the Short-Term Lending Code and was authorized to be in non-conformance;

(e) The premises meet all other applicable health, safety, zoning, property maintenance, building and fire codes, and comply with all ordinances of the City;

(f) Applicant has provided the Director with a designated agent for service who can regularly be contacted in the City during normal business hours;

The Director or a designee is authorized to make inspections of the Short-Term Loan Establishment's premises at reasonable times and hours of any day for purposes of determining whether such Short-Term Loan Establishment fully complies with the provisions of the Short-Term Lending Code.

Sec. 7-41. – Approval or disapproval of application and hearing.

(a) The application for a Short-Term Loan Establishment permit, or the renewal thereof, authorized under the Short-Term Lending Code shall be approved or disapproved within 30 days from the date of the Director's determination that the application is complete, unless the applicant agrees in writing to an extension of that time period. If a permit application is disapproved, the Director shall notify the applicant by registered or certified mail to the business address stated in the applicant's application and shall state the basis for such disapproval.

(b) If within ten (10) days after the Director mails notice to an applicant that the application has been disapproved, the applicant files with the Director a written request for a hearing before the Director on whether the applicant has satisfied the criteria set forth in this Section of the Short-Term Lending Code; then, the Director shall within five days of receipt of a timely request, mail a notice of

hearing to the applicant, which shall include the date, time and place for the hearing before the Director. The date for the hearing shall not be less than 10 days, nor more than 40 days, following receipt by the Director of the request for a hearing by applicant under this section, unless the aggrieved party requesting the hearing agrees to extent the time for the hearing or except for good cause shown.

Sec. 7-42. – Display of permit.

Every individual, firm, corporation, partnership, organization, or association holding a permit under the Short-Term Lending Code as a Short-Term Loan Establishment shall post its permit in a conspicuous place and manner on the premises.

Sec. 7-43. – Compliance with the Short-Term Lending Code and other regulations.

It shall be the duty of a permittee to comply with all the provisions of the Short-Term Lending Code and with all regulations issued by the Director pertaining to Short-Term Loan Establishments. Failure to comply with the Short-Term Lending Code or regulations after written notification of noncompliance has been delivered to the permittee by the City is a permissible basis for revocation or nonrenewal of the permit.

Sec. 7-44. – Notice on premises required.

(a) Permitees shall conspicuously post in the lobby of the office, in at least fourteen-point bold type, the maximum annual percentage rates such licensee is currently charging and the statement:

NOTICE:

This lender offers short-term loans. Please read and understand the terms of the loan agreement before signing..

(b) It shall be the affirmative duty of each permittee to post a notice printed in not less than 24-point bold type within 3 feet of each location within the premises at which a customer, borrower, or other member of the general public is invited or directed to stand or sit to either apply for a loan, to answer or ask questions, to review or sign transaction documents, or receive loan proceeds, to make payments or to inquire about, or apply for, the renewal or the rolling over of a loan, which sets out the following information:

(1) The word "NOTICE" in bold capital letters;

(2) That this establishment is a short-term loan establishment and is not a federally chartered bank, savings and loan association, or credit union;

(3) The interest rates and fees charged;

(4) The annual percentage rate equivalent of the aggregate of those interest rates and fees charged per $100.00 borrowed;

(6) A warning that default may result in loss of property used as security for the loan and garnishment of wages and checking and savings accounts; and

(7) Notice and clear explanation of any state or federal rights to rescind the loan agreement.

(c) The permittee shall provide each borrower with a notice in substantially the following form set forth in at least ten-point bold type, and receipt thereof shall be acknowledged by signature of the borrower:

(1) This lender offers short-term loans. Please read and understand the terms of the loan agreement before signing.

(2) You may cancel this loan without costs by returning the full principal balance to the lender by the close of the lender's next full business day.

(d) Failure to comply with the requirement of this section and all other requirements of the Short-Term Lending Code is unlawful.

Sec. 7-45. – Referral to Alternative Financial Assistance.

It shall be the affirmative duty of each permittee to provide to all interested customers and patrons a guide regarding alternatives to short-term loans in a form satisfactory to the Director.

Sec. 7-46. – Revocation or denial.

(a) Any permit issued under the provisions of the Short-Term Lending Code may be revoked or any permit may be denied by the Director, after due notice and affording an opportunity for a hearing, for any violation of the provisions of the Short-Term Lending Code and as otherwise provided in the Liberty City Code.

(b) Procedures. The procedure for and conduct of hearings under this section shall be as set forth in Sec. 7-41.

Sec. 7-47. – Renewal of permit.

(a) All Short-Term Loan Establishment permits shall expire on December 31 of each calendar year. Renewal applications for such permits shall be submitted between October 1 and November 30 of each calendar year, accompanied by payment in full of the fee stated in the Short-Term Lending Code, by cash, certified or cashier's check, or money order, and no application shall be considered complete until the fee is paid. The fee shall not be refunded under any circumstances. A Short-Term Loan Establishment permit issued under the Short-Term Lending Code may be renewed if an application in the form provided by the Director has been filed with the application fee with the Director and if the applicant is in compliance with the requirements of the Short-Term Lending Code for an original permit including but not limited to Section 7-40 of the Short-Term Lending Code.

(b) Upon timely application therefore, and subject to meeting the requirements in the Short-Term Lending Code for a new permit, a Short-Term Loan Establishment permit may be renewed by issuance of a new permit in the manner provided in the Short-Term Lending Code unless the Director disapproves the renewal application in the manner provided by Section 7-37 of the Short-Term Lending Code.

(c) If the application for renewal of a permit is not made during the time provided in subsection (a) of this section, the permit shall expire and the permittee shall cease all activities regulated by the Short-Term Lending Code and the permittee shall file a new application and meet all requirements of the Short-Term Lending Code before engaging in the business or occupations regulated under the Short-Term Lending Code. In addition, an application for renewal filed after the expiration date shall be treated as a new application.

SECTION II

Chapter 30, Unified Development Ordinance, Section 30-25.5 Special Use Permits, uses to be considered, of the Code of the City of Liberty, Clay County, Missouri is hereby amended as follows:

(43) Short-Term Loan Establishments and pawn shops in accordance with the following provisions:

a. The business is not located within 5,280 feet of any other Short-Term Loan Establishments or pawn shop; and
b. The business is not located within 200 feet of a residential, church, park or school property.

is hereby repealed and replaced with the following regulations:

(43) Short-term loan establishments and pawn shops in accordance with the following provisions:

(a) No such establishment shall be located within 5,280 feet of another short-term loan establishment or pawn shop. When measuring separation distances between establishments on the same lot, the distance shall be measured from the front door of each of the establishments.

(b) No such establishment shall be located adjacent to and within 200 feet of a residential, church, park, or school property.

(c) Such establishment may be operated only as a principal use of a property and may not be accessory to any other use. A short-term loan establishment may not operate any accessory uses.

(d) No permit shall be issued for a short-term loan establishment where it is determined that the total number of such facilities will exceed a population density factor of one such establishment per 15,000 residents based on the last decennial census.

SECTION - III

Nothing in this Ordinance shall be construed to affect any suit or proceeding now pending in any court or any rights acquired, or liability incurred nor any cause of causes of action occurred or existing, under any act or ordinance repealed hereby.

SECTION IV

If any section, subsection, sentence, clause, or phrase of this Ordinance is for any reason held to be invalid, such decision shall not affect the validity of the remaining portions of this Ordinance. City Council hereby declares that it would have adopted the Ordinance and each section, subsection, sentence, clause or phrase thereof, irrespective of the fact that any one or more sections, subsections, sentences, clauses, or phrases be declared invalid.

SECTION V

This Ordinance shall be in full force and effect from and after passage except that the fee provision shall not be in full force and effect until January 4, 2020, which is 60 days after the voters of the City of Liberty passed a ballot measure that authorizes

ORDINANCE NO. 11182 (CONT.)

the fee for the Short-Term Loan Establishment permit described in this Ordinance.

SECTION VI

That this Ordinance shall be in full force and effect from and after its passage by the City Council and approval by the Mayor according to law.

PASSED by Council this 25 day of November, 2019.

Lyndell W. Branton
MAYOR

ATTEST:

Janet Pitt
DEPUTY CITY CLERK

APPROVED by the Mayor this 25 day of November, 2019.

Lyndell W. Branton
MAYOR

Rel: January 10, 2020

ALABAMA COURT OF CIVIL APPEALS

OCTOBER TERM, 2019-2020

2181042

Renter's Realty

v.

Ieisha Smith

Appeal from Madison Circuit Court
(CV-18-69)

PER CURIAM.

Renter's Realty ("Renter's") appeals from a judgment of the Madison Circuit Court ("the circuit court") discharging a writ of garnishment that had been issued by the Madison District Court ("the district court"). In doing so, the

circuit court granted Ieisha Smith's "Declaration and Claim of Exemption" and denied Renter's objection to that claim.

This is the second appeal to this court that has arisen from the writ of garnishment issued in this action. The record from the previous appeal, Smith v. Renter's Realty, [Ms. 2180304, July 12, 2019] ___ So. 3d ___ (Ala. Civ. App. 2019) ("Smith I"), which the parties have asked to be incorporated as the record in the current appeal, indicates the following. In the district court, Renter's prevailed against Smith in its unlawful-detainer action against her, and the district court entered an order of possession in favor of Renter's. Subsequently, on December 22, 2016, the district court entered a judgment ordering Smith to pay damages and costs in the amount of $5,145. Smith did not appeal from the December 22, 2016, judgment.

Nothing in the record indicates that Smith paid the judgment or attempted to arrange a payment schedule with Renter's. Thus, on May 17, 2017, Renter's filed a process of garnishment in the district court, and on May 18, 2017, a writ of garnishment was issued to Smith's employer. On June 12, 2017, Smith filed in the district court a motion to stay the

garnishment, a verified declaration, and a claim of exemption. In her claim of exemption, Smith asserted that her biweekly wages were approximately $900 or less and that she used all of her income to pay current expenses for her family and herself. She said that she did not accumulate wages from paycheck to paycheck. Citing Art. 10, § 204, Ala. Const. 1901 ("§ 204"), Smith claimed that her wages were exempt from garnishment.

The district court granted a stay on June 13, 2017. On June 15, 2017, Renter's filed an objection to Smith's claim of exemption, arguing, among other things, that Smith was barred from claiming wages as personal property subject to exemption by application of § 6-10-6.1, Ala. Code 1975, which had become law on June 11, 2015. Approximately one year after the objection was filed, after a number of hearings, the district court entered a judgment on June 27, 2018, denying Smith's claim of exemption and reinstating the writ of garnishment. On July 2, 2018, Smith appealed to the circuit court. The record created in the district court was made a part of the circuit court's record.

On July 17, 2018, Smith filed in the circuit court a "response" to Renter's objection to her claim of exemption.

In that response, Smith argued that her wages could be claimed as a personal exemption under § 204 and Alabama caselaw dating to 1884. Smith and Renter's each filed trial briefs in the circuit court regarding the constitutionality of § 6-10-6.1, which provides:

> "(a) Wages, salaries, or other compensation of a resident are not personal property for the purposes of exemption from garnishment, levy, sale under execution, or other process for the collection of debt.
>
> "(b) It is the intent of this section to exclude from the meaning of personal property the wages, salaries, or other compensation of a resident for the purposes of the personal property exemption under Section 6-10-6[, Ala. Code 1975,] and Section 204 of the Constitution of Alabama of 1901."

On August 10, 2018, the circuit court held a hearing on Smith's claim of exemption and Renter's objection to the claim of exemption. On August 13, 2018, the circuit court entered a judgment stating that the attorneys for the parties had appeared before it on August 10, 2018, and had "consented to the Court rendering a decision on claim of exemption without further hearing." The circuit court then denied Smith's claim of exemption, citing § 6-10-6.1 and noting that that statute had become law before the writ of garnishment had been issued.

Smith timely appealed the circuit court's August 10, 2018, judgment to this court. This court determined that Smith had served the attorney general with notice of her constitutional challenge to § 6-10-6.1, as required by § 6-6-227, Ala. Code 1975. However, the matter had proceeded to trial before the attorney general's office had had the opportunity to respond. Accordingly, on the authority of Armstrong v. Roger's Outdoor Sports, Inc., 581 So. 2d 414 (Ala. 1990), this court remanded the case to the circuit court to allow the attorney general the opportunity to intervene in the action or to waive any right to intervene. The circuit court was instructed to render a valid judgment on the issue of the constitutionality of § 6-10-6.1. Smith I, ___ So. 3d at ___.

On remand, the attorney general's office waived any right to be heard in this matter. The circuit court held a hearing, and on August 12, 2019, it entered a judgment dismissing the garnishment and declaring § 6-10-6.1 unconstitutional. The circuit court stated that the statute "'represents an unconstitutional overreach by the legislature and a violation of the separation of powers principles.'" Smith v. Renter's

Realty, [Ms. 2180304, Oct. 4, 2019] ___ So. 3d ___, ___ (Ala. Civ. App. 2019)(opinion on return to remand)("Smith II").

Because Smith had ultimately prevailed in the matter in the circuit court, she did not have an adverse ruling from which to appeal. Smith II, ___ So. 3d at ___. Accordingly, in Smith II, this court dismissed Smith's appeal of the circuit court's judgment.

Upon the entry of the August 12, 2019, judgment, Renter's, which had previously been the prevailing party, had an adverse judgment from which it could appeal. On September 23, 2019, Renter's filed a timely appeal from that judgment. This court granted the parties' request to rely on the arguments set forth in their respective briefs and the submitted record from the previous appeal, i.e., Smith I, regarding the constitutionality of § 6-10-6.1.

Section 204 provides:

> "The personal property of any resident of this state to the value of one thousand dollars, to be selected by such resident, shall be exempt from sale or execution, or other process of any court, issued for the collection of any debt contracted since the thirteenth day of July, eighteen hundred and sixty-eight or after the ratification of this Constitution."

Section 204 is the successor to an identical provision in Article X, § 1, Ala. Const. 1875.

"The purpose of the exemption laws is to protect the debtor and his family from being deprived of the items necessary for subsistence, and possibly to prevent them from becoming a burden upon the public." Ex parte Avery, 514 So. 2d 1380, 1382 (Ala. 1987). See also Coffman v. Folds, 216 Ala. 133, 136, 112 So. 911, 913 (1927)(quoting Levens v. State, 3 Ala. App. 45, 50, 57 So. 497, 498-99 (1912), quoting in turn State v. Johnson, 12 Ala. 840, 841 (1848))(holding, in the context of an attempted levy of attachment or execution of exempt items, that "'"articles of prime necessity for the comfort of the family should be kept inviolate for its use"'").

In Enzor v. Hurt, 76 Ala. 595 (1884), our supreme court discussed the meaning of "personal property" as that term was used in the Alabama Constitution of 1875. The Enzor court declared:

> "We have often decided, that our exemption laws, being founded in a spirit of humanity and benevolence, were to be liberally construed; and such a rule of construction necessarily induces us to attach to the phrase 'personal property,' as used in those laws, a comprehensive signification. It

> was, in our judgment, intended to embrace everything which is the subject of ownership, not being realty, or an interest in realty."

76 Ala. at 597.

Nearly 100 years after Enzor was decided, this court noted that there had been no Alabama decision contrary to Enzor and further observed that our supreme court had held "in Kennedy v. Smith, 99 Ala. 83, [88,] 11 So. 665[, 666 (1892)], that the words 'personal property,' in the exemption laws embraced a debt due a defendant in execution, so there is no question that wages due a defendant in a garnishment suit is personal property." Walker v. Williams & Bouler Constr. Co., 46 Ala. App. 337, 340, 241 So. 2d 896, 899 (Civ. 1970).

By any objective standard, "wages, salaries, or other compensation of a resident," § 6-10-6.1(a), constitute personal property. The Alabama Constitution of 1901, building on precedent, explicitly mandates that "[t]he personal property of any resident of this state to the value of one thousand dollars, to be selected by such resident, shall be exempt from sale or execution, or other process of any court, issued for the collection of any debt contracted ...." § 204.

> "The Constitution of Alabama, like that of the nation and of the other states, is the supreme law

> within the realm and sphere of its authority. Subject only to the restraints resulting from the Constitution of the United States, the Constitution of Alabama is the highest form and expression of law that exists in this state. The source of its creation and the character of its sanction, viz. the people's deliberate will, invest the Constitution with its paramount quality. The Constitution's control is absolute wherever and to whatever its provisions apply; and every officer, executive, legislative, and judicial, is bound by oath ([Art. XVI,] section 279) to support the Constitution, to vindicate and uphold its mandates, and to observe and enforce its inhibitions without regard to extrinsic circumstances. It commits to no body, officer, or agent any authority or power whatever to change or modify or suspend the effect or operation of its mandates or its prohibitions; the instrument itself prescribes the exclusive modes by which it may be altered or amended, or its effect and operation changed. Otherwise than as these exclusive modes contemplate and authorize the Constitution's alteration, its character is permanent, its force and influence enduring. Both of these exclusive modes are plainly stated in [Art. XVIII,] sections 284-287 of the [Alabama] Constitution. Only through a constitutional convention, called and convened as provided in the existing organic law, or through amendment proposed and adopted as provided in the existing organic law, can the Constitution be altered or changed."

Johnson v. Craft, 205 Ala. 386, 393, 87 So. 375, 380 (1921). Stated more succinctly, "[t]he constitution of this state is the supreme law and limits the power of the legislature. Alexander v. State, 274 Ala. 441, 150 So. 2d 204 (1963)." Grantham v. Denke, 359 So. 2d 785, 787 (Ala. 1978).

In Johnson, our supreme court eloquently explained that the state legislature did not have the authority to alter or amend the Alabama Constitution merely by enacting a law contrary to the dictates of the constitution, stating:

> "Upwards of 60 years ago [now more than 160 years ago] this court had occasion to consider and to pronounce constitutional principles referable to the change by amendment of the organic law. The opinion then delivered by Justice Goldthwaite established Collier v. Frierson, 24 Ala. 100 [(1854)], as a leading authority in our country on the subject under consideration. Many courts of the highest repute, as well as text-writers, have accorded the doctrine there announced the unreserved acceptance its obvious soundness deserves, and have given that pronouncement its own great place in the constitutional jurisprudence of the republic. With a brevity, and also a comprehension, that is notable and gratifying, it was there said:
>
>> "'We entertain no doubt, that, to change the Constitution in any other mode than by a convention, every requisition which is demanded by the instrument itself must be observed, and the omission of any one is fatal to the amendment. We scarcely deem any argument necessary to enforce this proposition. The Constitution is the supreme and paramount law. The mode by which amendments are to be made under it is clearly defined. It has been said that certain acts are to be done, certain requisitions are to be observed, before a change can be effected. But to what purpose are these acts required, or these requisitions enjoined, if the Legislature, or any other department of the government, can dispense with them. To do so would be

> to violate the instrument which they are sworn to support, and every principle of public law and sound constitutional policy requires the courts to pronounce against every amendment, which is shown not to have been made in accordance with the rules prescribed by the fundamental law.'
>
> "[24 Ala. at 109.]"

205 Ala. at 393, 87 So. at 380. The Johnson court went on to explain how changes to the Alabama Constitution are to be accomplished, stating:

> "The provisions of the Constitution providing for its amendment are mandatory, not directory--binding on the people themselves and concluding every department, body, officer, and agency under its authority. ... 12 C.J. pp. 688, 689. The power granted the Legislature to propose amendments to the Constitution is a particular, special power, not possessed by the Legislature otherwise than through grant by the instrument itself. It can only be exercised in the mode prescribed, and the mode defined is the measure of the power. Collier v. Frierson, [24 Ala. 100 (1854)]; Oakland [Paving] Co. v. Hilton, 69 Cal. 479, 514, 11 Pac. 3 [(1886)]; Jones v. McDade, [200 Ala. 230, 75 So. 988 (1917)]. It results from the system and the provision of the Constitution that in proposing amendments to that instrument, to be voted upon by the electorate, the Legislature is not exercising its other power to make laws. Jones v. McDade, supra; Livermore v. Waite, 102 Cal. 113, 36 Pac. 424, 25 L.R.A. 313, 315, 316 [(1894)]; 12 C.J. p. 693; 6 R.C.L. § 19, pp. 28, 29. Recognition of this last-stated principle--resultant, as it is, from those previously reiterated--is an essential prerequisite to any sound, logical conclusion upon the objection now being considered. To ignore it or to deny it

> appropriate effect is to invite error in judgment and to court the affirmation of inexcusable fallacy."

205 Ala. at 393-94, 87 So. at 381.

The legislature openly declared that its purpose in enacting § 6-10-6.1 was to redefine the meaning of "personal property" in § 204, stating in the statute:

> "(b) It is the intent of this section to exclude from the meaning of personal property the wages, salaries, or other compensation of a resident for the purposes of the personal property exemption under Section 6-10-6 [, Ala. Code 1975,] and Section 204 of the Constitution of Alabama of 1901."

None of the methods that are required by the Constitution itself for making such an alteration were followed. See Art. XVIII, §§ 284-287, Ala. Const. 1901; Johnson, supra. Instead, the legislature attempted to effect the change through its own legislation.

We agree with the circuit court's determination that the legislature's effort to redefine "personal property" in § 204 was an impermissible "overreach" and that § 6-10-6.1 is, therefore, unconstitutional. Accordingly, the judgment of the circuit court is affirmed.

AFFIRMED.

All the judges concur.