

February 4, 2020

Robert E. Feldman  
Executive Secretary  
Attention: Comments  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429

**Re: *Federal Interest Rate Authority***  
***RIN: 3064-AF21***

The American Financial Services Association (AFSA)<sup>1</sup> appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) proposed rule (Proposed Rule) which 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 Rule also would provide that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act (FDI Act) would be determined at the time the loan is made. The Proposed Rule also states that 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.

As the FDIC acknowledges, recent developments have created uncertainty about the ongoing validity of interest-rate terms after a state bank sells, assigns, or otherwise transfers a loan. AFSA supports the Proposed Rule, which will help American consumers by providing much needed clarification in this area.

The Proposed Rule implements section 27 of the FDI Act. It would expressly codify what the FDIC and the financial services industry have always believed and address the recent confusion about the impact of an assignment on the permissible rate of interest.

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

On the first point, as the FDIC outlines in the Proposed Rule, 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). It is well-established that 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. Furthermore, as explained in the Proposed Rule, the ability of an assignee to enforce a loan's interest-rate terms is also consistent with fundamental principles of contract law.

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

Until the U.S. Court of Appeals for the Second Circuit’s decision in *Madden v. Midland Funding, LLC*,<sup>2</sup> no court had failed to apply the basic rule that usury is determined at the time of loan origination and subsequent events, such as a bank’s assignment of a valid loan to another institution, cannot render the loan usurious.

Despite that fact that the longstanding common law “valid-when-made” principle is well-established, the *Madden* decision created uncertainty regarding the ongoing validity of the contracted interest rate after a loan is assigned. This leads us to our second point. Uncertainty in this area harms not only the financial services industry, but is detrimental to consumers.

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

“Last year’s Second Circuit decision surely made *Madden* happy, but it is unlikely to benefit future borrowers who find themselves in her position. Riskier applicants are more likely to be among those rationed out of the borrower pool. There is, in fact, already evidence that *Madden* has changed the fortunes of borrowers in the three states covered by the Second Circuit’s ruling. Those with low credit scores saw loan volumes decline by half in the months after the ruling; for similar borrowers elsewhere in the country, loan volumes more than doubled.”<sup>3</sup>

A paper by the Mercatus Center at George Mason University examined the impact of the *Madden* decision on credit access. The Mercatus Center found that, “The case has produced considerable fallout in the Second Circuit, including a significant reduction in credit for borrowers with lower credit scores (who would be charged a higher rate).”<sup>4</sup> The paper cited Professors Colleen Honigsberg, Robert J. Jackson, and Richard Squire, who documented this decline. They found that the number of loans made to less-creditworthy borrowers in the Second Circuit declined by 52 percent. At the same time, the number of loans made to similarly situated borrowers not in the Second Circuit increased by 124 percent.<sup>5</sup>

Another study, written and presented at the Philadelphia Federal Reserve by two university researchers, found a positive correlation between the rise in personal bankruptcies in states within the Second Circuit and the decline in marketplace lending.<sup>6</sup> “Using monthly data from the U.S. Courts Administrative Office, we show that personal bankruptcy filings rise by 8% more in Connecticut and New York relative to other states following *Madden*. This is driven by an increase in Chapter 7 and 13 bankruptcies.”<sup>7</sup> The same study also found, “Consistent with classical price theory, the interest rate controls imposed by *Madden* result in credit rationing. Lending Club and Prosper, the two largest U.S. marketplace lenders, significantly reduce lending in the affected states. The volume and number of marketplace loans declines by 10% and 13.4%, respectively.”<sup>8</sup>

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

<sup>3</sup> Zuluaga, Diego. *Invalid When Made: The District Court’s Madden v. Midland Decision*. CATO Institute. March 20, 2018. Available at: <https://www.cato.org/blog/invalid-when-made-district-courts-madden-v-midland-decision>.

<sup>4</sup> Knight, Brian. *Risks to Innovative Credit Posed by Emerging Regulatory and Litigation Trends*. Mercatus on Policy. Jan. 2017. Available at: <https://www.mercatus.org/system/files/knight-risks-innovative-credit-mop-v1.pdf>.

<sup>5</sup> *Ibid.*

<sup>6</sup> Danisewicz, Piotr and Ilaf Elard. *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy*. July 5, 2018. Available at SSRN: <https://ssrn.com/abstract=3208908> or <http://dx.doi.org/10.2139/ssrn.3208908>.

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

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

“Thus, while the *Madden* decision might end up decreasing the interest rates charged on some loans, it almost certainly will decrease the availability and increase the cost of credit, particularly for small businesses and lower-income families. Because loans to such borrowers carry greater credit risk, such loans require higher interest rates, thus creating greater exposure to usury limits. If a bank originates such a loan, bank capital regulation has already dramatically increased its cost of holding it, and *Madden* will significantly limit the ability to securitize it.”<sup>9</sup>

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

“Some financial institutions have reportedly imposed restrictions on credit facilities used to finance consumer lending, prohibiting loans to borrowers in the Second Circuit if those loans bear interest at rates higher than the state-enacted usury rates. Similar effects have been felt in the securitization market, as firms have removed loans made to borrowers in the Second Circuit from asset-backed securitizations due to usury concerns. And the impact will almost certainly be even greater in the future.”<sup>10</sup>

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

Sincerely,



Celia Winslow  
Senior Vice President  
American Financial Services Association

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<sup>9</sup> Pidano Paige E. *Bill to correct Madden ruling would benefit consumers*. American Banker. Feb. 28, 2018. Available at: <https://www.americanbanker.com/opinion/bill-to-correct-madden-ruling-would-benefit-consumers>.

<sup>10</sup> *Ibid.*