THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT (DIDMCA)

Overview

Since the passage of the Federal Reserve Act in 1913, few pieces of legislation have had as noteworthy of an impact on Federal Reserve operations as the Depository Institutions Deregulation and Monetary Control Act (DIDMCA).[1] The act focused on two areas of concern for the federal government in the late 1970s: improving the control of monetary policy by the Federal Reserve and deregulation of financial institutions that accept deposits.[2]

Title I of the act is known as the Monetary Control Act of 1980 and was instituted as a result of high inflation and tight monetary controls. This part of the act encouraged all depository institutions to opt in to the federal reserve system.[3] The Federal Reserve Board of Governors uses federal regulations and other tools to direct the money supply and shift the monetary system away from drastic inflation or deflation. The federal reserve system requirements for depository institutions includes an account at the federal reserve bank or to create a form of "vault cash" that holds in reserve a balance based on the amount of the institution's deposits.[4] States that opt into Title I gained access to the federal discount borrowing status. Other benefits for opting in are that more financial services can be offered to consumers, such as interest-bearing checking accounts, automatic transfer services from checking to savings accounts, expanded FDIC coverage from $40,000 to $100,000 on deposits and allowing the depository institutions to charge fees for the new services.[5]

Title II of the act is known as the Depository Institutions Deregulation Act of 1980. This act phased out restrictions on interest rates that state depository institutions could offer to their customers.[6] Before the enactment of Title II, the maximum interest rate that state banks could pay on deposits was regulated by the federal government under what was known as Regulation

[1] Federal Reserve History, *Federal Reserve Act Signed into Law*, at https://www.federalreservehistory.org/essays/federal-reserve-act-signed, (November 2013).
[2] Federal Reserve History**,** *Depository Institution Deregulation and Monetary Control Act*, https://www.federalreservehistory.org/essays/monetary-control-act-of-1980, (November 2013).
[3] *Ibid.*
[4] *Ibid.*
[5] Federal Reserve History**,** *Depository Institution Deregulation and Monetary Control Act*, at https://www.federalreservehistory.org/essays/monetary-control-act-of-1980, (March 1980).
[6] *Ibid.*

Q.[7] Banks were not allowed to pay more than 5.25 percent at the time of Title II's passage,[8] and market interest rates were in the double digits; short-term Treasury securities were over 12 percent. Banks and other traditional types of depository institutions could not compete in attracting customer saving deposits compared with unregulated or less-regulated competitors. Consumers began to avoid state banks and placed their savings in unregulated entities such as mutual funds.[9] The freeing of financial markets so state banks could compete for depositors' funds benefited consumers through new incentives to save and help financial markets function more smoothly.

For the consumer credit industry, the most consequential changes came in Title V—State Usury Laws. With sections related to mortgages, business and agricultural loans, and other loans, Title V preempts state usury laws by allowing FDIC-insured state-chartered banks to contract for the interest rate permitted by the state in which the bank is located and export that interest rate into other states. DIDMCA passed a little over one year following the Supreme Court's decision in *Marquette v. First of Omaha Service Corp.*, which established that the National Bank Act allows national banks to export interest rates across state lines. In enacting Title V of DIDMCA, Congress intended to level the playing field between state and national banks and provide state-chartered banks with the same privileges. In fact, Section 521 of DIDMCA starts: "In order to prevent discrimination against State-chartered insured banks…with respect to interest rates." Importantly, the ability to export interest rates applies across credit products, including small loans, credit cards, and vehicle financing.

State Opt-Outs

While DIDMCA did level the playing field with respect to interest rate exportation, there is one crucial difference between DIDMCA and the National Bank Act: state opt-outs. In order to assuage states' rights concerns, Section 525 of DIDMCA allows states to opt out of the interest rate exportation in Section 521. States began opting out of DIDMCA within months of its enactment. In total, seven states[10] and **Puerto Rico** opted out of the act.[11] Over the following two decades, six of those states opted back in, with only **Iowa** and Puerto Rico remaining.[12]

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[7] Federal Register, *Regulation Q; Regulatory Capital Rules: Interim Final Rule To Exempt Small Savings and Loan Holding Companies From the Regulatory Capital Rules*, at https://www.federalregister.gov/documents/2015/02/03/2015-02038/regulation-q-regulatory-capital-rules-interim-final-rule-to-exempt-small-savings-and-loan-holding, (February 2015).

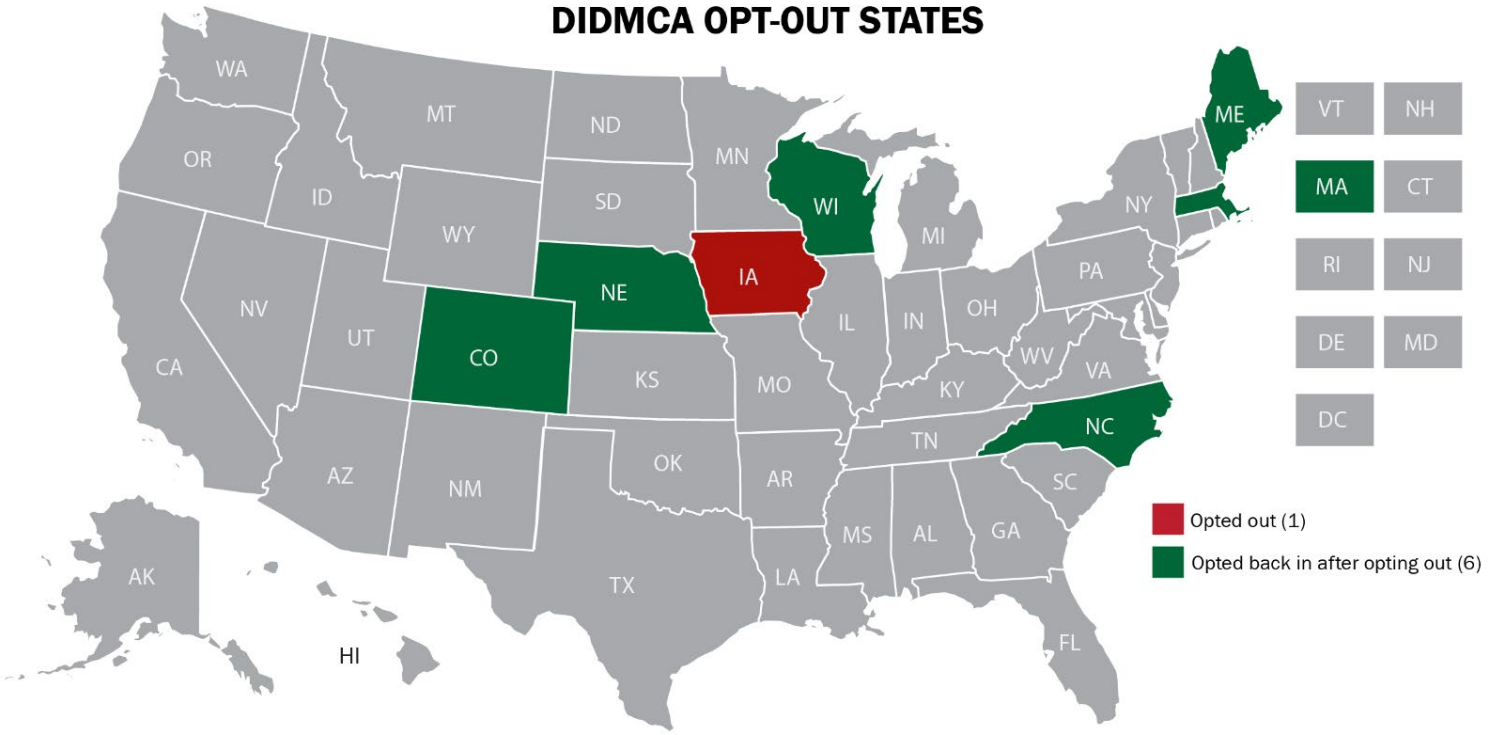
[8] Federal Reserve History**,** *Depository Institution Deregulation and Monetary Control Act*, https://www.federalreservehistory.org/essays/monetary-control-act-of-1980, (November 2013).

[9] *Ibid.*

[10] These states are **Colorado**, **Iowa**, **Maine**, **Massachusetts**, **Nebraska**, **North Carolina** and **Wisconsin**.

[11] Troutman Pepper LLC, *Colorado Introduces Bill to Opt-Out of DIDMCA*, Prevent interest Rate Exportation, at https://www.consumerfinancialserviceslawmonitor.com/2023/04/colorado-introduces-bill-to-opt-out-of-didmca-prevent-interest-rate-exportation/, (April 25, 2023).

[12] Mayer Brown LLP, *Iowa Targets Out-of-State Bank Partner for Usury*, at https://www.mayerbrown.com/en/perspectives-events/publications/2023/01/iowa-targets-outofstate-bank-partner-for-usury-shedding-light-on-states-interpretation-of-didma-optout#:~:text=DIDMCA%20allowed%20the%20states%20to,that%20chose%20to%20opt%20out., (January 12, 2023).



As the only state that never opted back in, Iowa continues to test the limits of its authority over the interest rates charged by state-chartered banks on loans to Iowa borrowers.[13] The state recently settled with Transportation Alliance Bank,[14] a federally insured, Utah-chartered bank, over rate cap violations resulting from its partnership with a nonbank lender. Under the settlement, the bank did not admit to violations of DIDMCA, but the bank did cease making loans in Iowa.

Lending through bank partnerships—often characterized by consumer activists as "rent-a-bank"—has become a target for state regulators in recent years. Viewed by activists and some policymakers as an attempt to evade state usury laws, these arrangements involve nonbank lenders partnering with a state or federally chartered bank to make a loan that is later acquired by the nonbank lender. Because of the partnership with the bank, these loans typically involve exported rates, sometimes in excess of the state's usury laws.[15] With the rise of such partnerships, states have attempted to stop rate cap evasion through enforcement actions and law changes, including tests related to which entity holds the predominant economic interest in the

[13] Mayer Brown LLP, *Iowa Targets Out-of-State Bank Partner for Usury*, at https://www.mayerbrown.com/en/perspectives-events/publications/2023/01/iowa-targets-outofstate-bank-partner-for-usury-shedding-light-on-states-interpretation-of-didma-optout#:~:text=DIDMCA%20allowed%20the%20states%20to,that%20chose%20to%20opt%20out., (January 12, 2023).

[14] Iowa Attorney General, *Assurance of Discontinuance*, at https://www.iowaattorneygeneral.gov/media/cms/TAB_Bank__SOI_Assurance_of_Disconti_92D5556A9591B.pdf, (December 13, 2022).

[15] Scholarship Law Duke University, *Rent-A-Bank: Bank Partnerships and the Evasion of Usury Laws*, at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4091&context=dlj, (2021).

loan. Most recently, consumer activists have suggested states consider opting out of DIDMCA, as Iowa has done, to prevent rates from being exported into the state.

In its 2023 session, the **Colorado** legislature passed HB 1229, which, among other changes, would opt the state out of DIDMCA again, forcing state-chartered banks to comply with Colorado's interest rate caps. AFSA opposed these changes and filed comment letters throughout the process outlining the issues with opting out of DIDMCA. The bill was transmitted to Democratic Governor Jared Polis on May 22. Governor Polis has until June 8 to act on the bill or it becomes law without signature. If enacted, the opt-out would not take effect until July 1, 2024.

Opt-out Complications

Although consumer activists and some Colorado policymakers have treated opting out of DIDMCA as a silver bullet solution to preventing bank partnership lending, the reality is much more complicated. First, this opt-out only applies to state-chartered institutions and would do nothing to address any lending by national banks or even tribal lenders. Second, the exact impact of opting out is largely unsettled law; while a bank chartered in a state that has opted out would be prevented from exporting its home state rates into other states, banks chartered in other states would not automatically be prevented from exporting rates into an opt-out state. For instance, the Federal Deposit Insurance Corporation (FDIC) has taken the position that a state opting out under Section 525 should not affect the rate preemption for a bank not located in that state, as long as the loan is not made in the state that has opted out; in practice, determination of where a loan is "made," is not as simple as the borrower's location and is instead based on an analysis of the facts surrounding the extension of credit.[16] The FDIC determined that which state's rates apply 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 functions involved in making the loan are performed by a branch or branches located in the state that has opted out, the opt-out state's interest rate restrictions would apply to the loan; otherwise, the state-charted bank would be able to export its home-state rate. If the functions occur in different states, the opt-out state's rates may be applied if the loan has a clear nexus to that state.[17]

There are also legal questions related to whether the right to opt-out of DIDMCA even still exists. It's possible that Section 407 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) repealed Section 525 of DIDMCA, which would mean states no longer have the ability to opt-out. This matter is, again, unsettled, but at least two cases, including one in Colorado, support this conclusion.[18]

State opt-outs create a number of negative impacts for the industry. First, it would return a state to the unlevel playing field that existed before DIDMCA, with competitive imbalance between

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[16] Dreher Tomkies LLP, *A Potential Revival of Section 525 State Opt-Out From Federal Preemption?*, at https://www.dltlaw.com/wp-content/uploads/sites/1602755/2023/05/Alert-A_POTENTIAL_REVIVAL_OF_SECTION_525_STATE_OPT_OUT_FROM_FEDERAL_PREEMPTION_.pdf, (April 26, 2023).
[17] Federal Deposit Insurance Corporation, *Federal Interest Rate Authority,* 85 Fed. Reg. 44146, (July 22, 2020).
[18] Hudson Cook, *Much Ado About Colorado*, at https://www.hudsoncook.com/article/much-ado-about-colorado/, (May 17, 2023).

national and state banks on rate exportation. From a consumer perspective, this would limit competition in the state for certain companies, leaving consumers with fewer choices and worse off as a result. It could also prove confusing for consumers who may seek credit at multiple types of financial institutions and see drastically different offers.

More importantly, opt-out efforts may be targeted at bank partnership lending, but the actual impact will be much wider. Many financial institutions maintain state-chartered banks for various types of lending, including vehicle financing and issuing credit cards. If a state opts out, the rates on these various credit products may already be below the state's usury limits, but the opt-out has other significant compliance implications, particularly with regard to other allowable fees. Based on recent discussions among policymakers and activists, it is not clear that proper consideration has been given to the wide-reaching effects a DIDMCA opt-out would actually have.

Conclusion

For more than 40 years, DIDMCA has had a positive impact on lending by maintaining a level playing field and providing flexibility for industry participants. [19] Although seven states opted out of DIDMCA initially, all but one have opted back in, recognizing the importance of the law. By opting out again, states risk limiting consumers' financial options and competition at a time when it is increasingly crucial for credit access to be available to all consumers. DIDMCA's federal preemption helped alleviate pressure from the high interest rate environment that existed in the late 1970s. Prior to DIDMCA's passage, interest rates were rising, but some rate caps prevented state-charted banks from adjusting their own interest rates commensurate with their significantly higher cost of funds. Decades later, we are in another high interest rate environment and the cost of funds for lenders has risen quickly. DIDMCA's changes provided relief to prevent market disruptions that could have limited credit accessibility. With similar circumstances, now is not the time to rethink DIDMCA. AFSA will continue to monitor this issue and ensure states are aware of DIDMCA's importance to consumer lending.

[19] Chicago Federal Reserve, *Landmark Financial Legislation for the Eighties*, at file:///Users/cynthia/Downloads/ep-sep-oct1980-part1-brewer-pdf.pdf, (October 1980).