BETTER MARKETS

— FACT SHEET —

Bank Regulators Are Paving the Way for Loan Sharks, Payday Lenders, and Debt Collectors to Gouge Consumers with Sky-High Interest Rates

Background

Most states have usury laws protecting their residents from predatory lenders who would gouge consumers with outrageous interest rates and fees. However, through a concept known as "interest rate exportation," which is based on court interpretations of the federal banking laws, state and national banks have been allowed to charge the interest rate permitted under the law of the state in which the bank is located, even if the loan is made to a resident of a state where that rate of interest would be illegal. In other words, a bank located in State A, with an interest rate cap of 50%, can make a loan to a resident of State B, with an interest rate cap of 15%, and charge the 50% rate of interest allowed by State A.

While this is a significant exception to state usury laws, it is not unlimited. Specifically, the ability of a bank to export interest rates has been limited to either the bank itself or to its affiliates, i.e. entities that are ultimately subject to the oversight of federal banking regulators. In a 2015 case, *Madden v. Midland Funding, LLC*, the Second Circuit addressed a situation where a national bank made a loan to a New York resident, charging an interest rate that would have been prohibited under New York law but for the fact that it was made by a national bank. The bank sold the loan to a debt collector and relinquished any interest it had in the loan. The debt collector that purchased the loan was not a bank or in any way affiliated with a bank. The Second Circuit came to the commonsense conclusion that the debt collector, being a non-bank, could not benefit from the federal preemption of state usury laws that are afforded to banks. Importantly, the Second Circuit recognized that allowing non-banks to circumvent state usury laws opens up a dangerous loophole in those essential consumer protection laws.

While *Madden* did not close that loophole completely, it created uncertainty and inhibited the growth of the "rent-a-bank" model, in which non-bank lenders partner with federally-regulated banks to benefit from the preemption of state usury laws. Unfortunately, the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") (collectively, "Agencies") have each proposed a rule ("Proposals") that would nullify the Second Circuit's sensible decision. They want to be sure the case doesn't stand in the way of any lending model—even those that circumvent state law and harm consumers.

In comment letters Better Markets filed on January 21, 2020 with the OCC and on February 4, 2020 with the FDIC, we urged the Agencies to withdraw the Proposals on three grounds: (1) the Agencies ignore the consumer harm that results from allowing non-banks to violate state usury laws; (2) the Agencies do not appear to have the legal authority to allow non-banks to violate state usury laws, since they are responsible for regulating banks; and (3) the Agencies fail to offer any evidence that the Proposals are necessary to protect the safety and soundness of banks.

The Agencies Fail to Address the Ominous Threat to Consumers Posed by the Proposal

The Second Circuit in *Madden* recognized that allowing non-banks, such as debt collectors, to benefit from interest rate exportation creates "an end-run around usury laws" for those non-banks and exposes consumers to crushing interest rates on their loans. In fact, prior to Madden, non-banks had begun avoiding state usury laws simply by entering a loan purchase arrangement with a bank and invoking federal pre-emption of those state laws. Under this "rent-a-bank" strategy, non-bank financial enterprises—ranging from online lenders to payday loan sharks—piggyback on the charters of national or other banks to become exempt from state usury laws. Indefensibly, the Agencies do not address this consumer harm. The FDIC even appears to favor the rent-a-bank model and attempts to justify its approach with the claim that it benefits consumers by affording them more "choice." But the choice to be gouged by loan sharks at sky-high interest rates is not a choice that regulators should protect. In reality, these Proposals will harm consumers: More and more Americans, vulnerable to being caught in an endless cycle of debt, will lose the protections that their states intended to provide to their citizens.

The Agencies Lack Apparent Authority for the Proposals

The National Bank Act and the Federal Deposit Insurance Act, by their terms, give **national and state banks**, respectively, authority to charge the rate of interest allowed by the state where they are located. The interest rate that non-banks are allowed to charge remains within the purview of state law. The Second Circuit's decision in *Madden*, which involved a **non-bank**, recognized this essential distinction. The Agencies' Proposals do not. They purport to address the authority of non-banks to charge usurious interest rates, even though neither of the Agencies has jurisdiction over non-banks. The Agencies attempt to overcome this hurdle by speculating that if **non-banks** such as debt collectors are not able to charge usurious interest rates on loans they buy from banks, **banks** may be hindered in their ability to sell or assign their loans, which may in turn have an impact on banks' abilities to manage risk, maintain liquidity, or engage in other practices essential to their business. But the Agencies offer no evidence for this speculation, and without evidence linking the application of state usury law to non-banks on the one hand, with banks' ability to carry out their functions on the other, the Proposals appear to exceed the Agencies' legal authority.

The Agencies Offer No Evidence to Justify the Proposals

The Agencies claim that the Second Circuit's *Madden* decision has created uncertainty that has impacted the ability of banks to manage risk, access funding, and provide for customer needs. But given that the *Madden* decision was issued in 2015, one would expect them to cite some evidence of these purported negative effects. Yet the Agencies offer none. Indeed, the FDIC, in its Proposal, candidly states that it "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." The Agencies, then, would allow predatory lenders to gouge consumers, all to solve a problem that doesn't exist.

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity Better Markets also fights to refocus finance on the real economy, empower the buyside, and protect investors and consumers.