January 21, 2020

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Suite 3E-218
400 7th Street, SW
Washington, DC 20219

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

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Office of the Comptroller of the Currency ("OCC"), regarding permissible interest rates on loans sold to non-banks.

The Release explains that it was issued to remove uncertainties potentially created by a Second Circuit decision that fortified the application of consumer protection laws—specifically state usury laws—to non-banks, *Madden v. Midland Funding, LLC*, 786 F.3d 246, 247 (2d Cir. 2015).

Unfortunately, the Release is flawed in at least three major respects, rendering it unlawful, arbitrary and capricious.

- First, it appears to exceed the scope of the OCC's legal authority by addressing the rights of **non**-national banks—unaffiliated in any way with a national bank—engaged in purchasing and collecting on consumer loans.

- Second, it offers no concrete evidence whatsoever to support the claim that the decision in *Madden* has created genuine and harmful uncertainty in the market for bank loans or

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 84 Fed. Reg. 64,229 (Nov. 21, 2019).

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that any such uncertainty has "significantly interfered" with any operations of any national bank, any exercise of any national bank's powers, or liquidity in the credit markets.

- Finally, the Proposal fails even to mention or address the ominous threat to consumers that it poses. By proposing to immunize non-national bank entities from state usury laws when they purchase loans outright from national banks, the Proposal will pave the way for unscrupulous loan sharks, payday lenders, and other predatory enterprises to partner with a national bank to gouge vulnerable borrowers with enormous interest rates with impunity—regardless of the protections that the borrower's home state determined were appropriate or necessary. Moreover, by failing to make clear that the OCC would sanction a national bank that engages in such behavior on behalf of a non-bank lender, the proposal all but encourages national banks to work with predatory lenders to help them avoid state regulations. This outcome would appear on its face to be unjustifiable, yet the Proposal fails even to address the issue.

We urge the OCC to withdraw the Proposal and re-release it, if at all, only after addressing all of the foregoing issues in detail by explaining the scope of its legal authority to issue such a Proposal; by justifying the Proposal, if possible, with thoroughly documented and credible evidence and analysis; and by forthrightly addressing the alarming implications and risks that the Proposal poses for countless borrowers in the credit market.

BACKGROUND AND SUMMARY OF THE PROPOSAL

Section 85 of the National Bank Act governs the interest rate that national banks may charge. It provides that a national bank may "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." 12 U.S.C. § 85. Court decisions have expanded this provision, so that a national bank located in a state that allows high interest rates and fees can then charge the residents of any other state those same interest rates and fees, even if they would be illegal in the customer's home state. This privilege has been expanded to include charges that are not strictly interest, such as late charges, and it also extends to the operating subsidiaries of the national bank.[3]

Essentially, courts have held that state usury laws are pre-empted with respect to national banks that charge interest or fees that are permissible under federal law. The asserted rationale is that application of those state laws would interfere the establishment of a national banking system by curtailing the authority of national banks.

[3] *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007); *Smiley v. Citibank (S. Dakota), N.A.,* 517 U.S. 735, 740 (1996); *Marquette Nat. Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 312 (1978)

In 2015, the Second Circuit issued its decision *Madden v. Midland Funding, LLC*, 786 F.3d 246, 247 (2d Cir. 2015). In *Madden*, FIA Card Services, N.A. ("FIA"), a national bank, issued a credit card to Madden, a New York resident. FIA charged an interest rate on Madden's credit card that would have been usurious under New York state law, but for the fact that FIA was a national bank. After FIA charged off the account, it sold the loan to Midland Funding LLC ("Midland"), which then attempted to collect the debt, purporting to charge the same interest rate as FIA (27%), which again was usurious according to New York law. Madden sued, alleging that Midland was charging an illegal interest rate under New York law. The Second Circuit held that New York's usury law was not preempted as to Midland, because: (1) Midland was not a national bank, (2) Midland was not affiliated with FIA, and (3) FIA retained absolutely no interest in the account. Therefore, application of New York's usury law did not interfere with the powers of a national bank, because no national bank was involved in the case.

The court in *Madden* was careful to acknowledge cases holding that some non-national bank entities may be permitted to invoke preemption of state law, but only if they are acting on behalf of national banks, as in the case of agents or operating subsidiaries. *Id.* at 250-51. Ultimately, the test is whether application of state law to the activities of such non-banks would "significantly interfere with a national bank's ability to exercise its power under the NBA." *Id.* at 250. The court held that a third-party debt collector which has purchased a national bank loan outright is acting on its own behalf, not on behalf of the national bank, and that applying state usury laws to such entities would not "significantly interfere" with the exercise of the national bank's powers:

> The defendants did not act on behalf of BoA or FIA in attempting to collect on Madden's debt. The defendants acted solely on their own behalves, as the owners of the debt. 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. *See Barnett Bank,* 517 U.S. at 33, 116 S.Ct. 1103. Rather, such application would "limit [ ] only activities of the third party which are otherwise subject to state control," *SPGGC, LLC v. Blumenthal,* 505 F.3d 183, 191 (2d Cir.2007), and which are not protected by federal banking law or subject to OCC oversight.

Midland, 786 F. 3d at 251.

In the Proposal, the OCC essentially seeks to reverse the Second Circuit's holding in *Madden* by providing that, if a national bank originates a loan and charges a permissible interest rate under the law of its home state, that interest rate remains permissible in all states, even if the loan is assigned to a non-national bank lender.

COMMENTS

1. **The OCC Fails to Explain the Legal Authority for Regulating the Permissible Interest Rates Applicable to Non-National Banks.**

The Proposal, which is in reaction to *Madden*, purports to provide clarity regarding national bank authority to charge particular interest rates and to assign contracts.[4] But *Madden* did not enlarge or restrict the authority of national banks to do anything. No national bank was being sued in *Madden*, and the Second Circuit's opinion, by its terms, does not in any way regulate the conduct of national banks. Moreover, the Proposal does not grant any additional power to national banks regarding interest rates or contract assignments that national banks do not already have. Instead, the Proposal purports to grant authority to **non-banks** to circumvent state usury caps.

In the Release, the OCC justifies its approach of giving non-banks the benefit of preemption by claiming 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."[5] But the OCC provides no evidence for this speculative assertion, it merely claims that it is so. And without any evidence providing a nexus between the *Madden* holding and any significant interference with the exercise of a national bank's powers, or any other negative impact on the national banking system that might support preemption of the application of state usury laws to non-banks, the Proposal appears to be beyond the OCC's legal authority.[6]

2. **The Lack of Evidence to Justify the Proposal Renders it Arbitrary and Capricious.**

Similarly, the OCC fails to offer any substantive policy justification for the Proposal. It is well-settled that when promulgating a rule, an agency "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." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S. Ct. 2856, 2866, 77 L. Ed. 2d 443 (1983). Here, the OCC states that *Madden* has "created

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[4] Release at 64,231.

[5] Release at 64,231.

[6] The Release raises vague concerns about the impact of *Madden* on the securitization market. But it fails to offer any concrete data, evidence, or analysis on that issue. Moreover, even assuming those concerns had some merit, the Proposal would at a minimum be overbroad. For example, *Madden* involved charged off debt, which was almost certainly sold for pennies on the dollar. Accordingly, it is highly unlikely that Midland actually expected to collect anything close to the full amount of interest on the debt, and so highly unlikely that application of New York's statutory cap would have had anything to do with its decision to purchase the loan from the national bank. The application of state usury laws in the scenario in *Madden* therefore had little if any impact on the ability of the bank to sell or assign its loans.

uncertainty" that banks' risk management tools "would be significantly weakened if the permissible interest on assigned loans were uncertain or if assignment of the permissible interest were limited only to third parties that would be subject to the same or higher usury caps."[7]

But given that the *Madden* decision came out in 2015, one would expect the OCC to offer some evidence that, in the intervening four years, the supposed "uncertainty" the court created has in fact impacted banks' ability to "rely on loan assignments and securitization to access alternative funding sources, manage concentrations, improve financial performance ratios, and more efficiently meet customer needs." *Id.* Yet the OCC offers none whatsoever. The lack of any evidence supporting the rationale for the Proposal renders it arbitrary and capricious.

3. <u>The OCC's Failure to Consider the Potential Consumer Harm Also Renders the Proposal Arbitrary and Capricious.</u>

The Proposal is also arbitrary and capricious because it "entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S. Ct. 2856, 2866, 77 L. Ed. 2d 443 (1983). Specifically, as the Second Circuit pointed out in *Madden:*

> [E]xtension of NBA preemption to third-party debt collectors such as the defendants would be an overly broad application of the NBA. Although national banks' agents and subsidiaries exercise national banks' powers and receive protection under the NBA when doing so, ***252** extending those protections to third parties would create **an end-run around usury laws** for non-national bank entities that are not acting on behalf of a national bank.[8]

The court's concern is real. For example, suppose a non-bank lender that wants to make loans to residents of a state and charge interest rates that exceed those allowed under that state's usury laws. Under the Proposal, it could do so legally simply through a purchase arrangement with a national bank based in a state that has weaker usury protections. Then the non-bank, without being subject to the supervisory oversight applicable to national banks or their affiliates, would be free to violate the state's usury caps. This threat is hardly new, as the rise in such "rent-a-bank" schemes is well-documented, where non-bank financial enterprises—ranging from online lenders to payday loan sharks—piggyback on the charters of national or other banks who are exempt from state regulatory requirements (including the usury laws) that would otherwise apply to the non-banks.

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[7] Release at 64,231.
[8] *Madden v. Midland Funding, LLC*, 786 F.3d 246, 252 (2d Cir. 2015).

In essence, the Proposal potentially renders state usury caps a nullity by allowing non-banks to violate all but the weakest existing caps with impunity, opening up huge opportunities for all manner of predatory payday lenders, loan sharks, and others to exploit vulnerable borrowers.

The Proposal entirely fails to address any consumer harm that will inevitably result if non-banks are able to freely violate a state's usury laws, nor does the OCC offer any proposal to mitigate the harm or ensure that the loophole it opens will not be abused. It expressly and completely side-steps the potential application of the "true lender" doctrine as a mitigant for the potential abuses that the Proposal would facilitate, and it devotes no consideration to other measures, such as federally-imposed interest rate caps in tandem with state limits. These omissions are indefensible in an area so rife with abuse.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

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