BILLING CODE 6714–01–P

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 [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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

- *Agency Web Site*: https://www.fdic.gov/regulations/laws/federal. Follow the instructions for submitting comments on the agency website.

- *E-mail*: 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, N.W., Washington, D.C. 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

[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).

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 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

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

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

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

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

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

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[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).

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

[10] Pub. L. 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).

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 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

[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, Pub. L. 96-221.

[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 § 998*1*. 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] Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994).

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—
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> (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

[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—
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> (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] Pub. L. 103-328, sec. 102(a).

[23] Pub. L. 105-24, 111 Stat. 238 (July 3, 1997).

> 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

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[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).

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 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.

[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).

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

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[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.

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

[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 N.W.2d 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.

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]

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[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).

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 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

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[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)).

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

[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).

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.

[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).

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 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

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

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.

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[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.

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 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.

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[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.

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

[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.

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 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.

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

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

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?

[56] Pub. L. 105-277, 112 Stat. 2681.

[57] Pub. L. 106-102, 113 Stat. 1338, 1471.

- 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

Sec.

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 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, D.C., on November 19, 2019.

Annmarie H. Boyd,

Assistant Executive Secretary

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