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IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

PEOPLE OF THE STATE OF CALIFORNIA, et al., Plaintiffs, v. **THE FEDERAL DEPOSIT INSURANCE CORPORATION,** Defendant.	Case No. 4:20-CV-05860-JSW **PLAINTIFFS' NOTICE OF MOTION, MOTION FOR SUMMARY JUDGMENT, AND MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** Date: August 6, 2021 Time: 9:00 a.m. Courtroom: Oakland Courthouse, Courtroom 5 – 2nd Floor Judge: The Honorable Jeffrey S. White Action Filed: August 20, 2020

NOTICE OF MOTION AND MOTION FOR SUMMARY JUDGMENT

PLEASE TAKE NOTICE that the undersigned shall, and do herein, move this court, at the Ronald V. Dellums Federal Building & United States Courthouse, Courtroom 5 – 2nd Floor, 1301 Clay Street Oakland, CA 94612, on August 6, 2021, at 9:00 a.m. for an order granting Plaintiffs the People of the State of California, the District of Columbia, the People of the State of Illinois, the People of the Commonwealth of Massachusetts, the State of Minnesota, the State of New Jersey, the People of the State of New York, and the State of North Carolina (collectively, "Plaintiffs") summary judgment pursuant to Fed. R. Civ. P. 56 on the basis of the administrative record and for the reasons stated below.

Plaintiffs ask the Court to declare that the Non-bank Interest Provision ("Provision") of the Federal Interest Rate Authority Rule, 85 Fed. Reg. 44,146-58, codified as part of 12 C.F.R. § 331.4(e), issued by the Federal Deposit Insurance Corporation on July 22, 2020, violates the Administrative Procedure Act, 5 U.S.C. § 706(2). Plaintiffs further ask the Court to hold unlawful and set aside the Provision and to grant other relief as the Court deems just and proper.

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SUMMARY OF ARGUMENT

States have long used interest-rate caps to prevent predatory lending. Congress first gave federally chartered national banks the statutory privilege of state rate-cap preemption, allowing them to charge interest rates in excess of state law. 12 U.S.C. § 85. To ensure that federally insured, state-chartered banks and insured branches of foreign banks ("FDIC Banks") could compete on a level playing field with national banks, Congress later gave FDIC Banks the same statutory privilege. 12 U.S.C. § 1831d.

Purporting to interpret § 1831d, the Non-bank Interest Provision ("Provision") of the Federal Deposit Insurance Corporation's ("FDIC") Federal Interest Rate Authority Rule, codified as part of 12 C.F.R. § 331.4(e), unlawfully extends preemption of state rate caps to any entity—bank or otherwise—that buys loans from an FDIC Bank. 85 Fed. Reg. 44,146-58 (July 22, 2020).

The Provision violates the Administrative Procedure Act ("APA," 5 U.S.C. § 706(2)), because the FDIC's interpretation of § 1831d conflicts with the unambiguous statutory text, which preempts state rate caps for FDIC Banks alone. Judicial constructions of § 1831d and comparison with a simultaneously drafted provision in the same legislation confirm that Congress did not intend to extend § 1831d beyond FDIC Banks. *E.g.*, *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 296 (3d Cir. 2005); 12 U.S.C. § 1735f-7a. The Provision, which regulates the rate that non-banks may charge and relies on FDIC Banks' state-law-derived right to sell loans, also exceeds the FDIC's authority because the FDIC may only regulate FDIC Banks and interpret federal law. *See* 12 U.S.C. §§ 1819(a), 1820(g). The Provision also impermissibly preempts state law. *Massachusetts v. U.S. Dep't of Transp.*, 93 F.3d 890, 896-97 (D.C. Cir. 1996).

The FDIC's action also violates the APA because it is arbitrary and capricious. The agency failed to address important aspects of the problem the Provision is intended to address, including the Provision's facilitation of "rent-a-bank" schemes and its creation of a regulatory vacuum. In addition, the evidence in the Administrative Record undermines the FDIC's alleged basis for the Provision, and the Provision conflicts with the FDIC's stated position against rent-a-bank schemes. *See, e.g.*, *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

INTRODUCTION

The Federal Deposit Insurance Corporation ("FDIC") seeks to unlawfully extend the privilege of exceeding state interest-rate caps, a privilege that Congress granted exclusively to banks over which Congress gave the FDIC regulatory authority. Section 27 of the Federal Deposit Insurance Act ("FDIA"), codified at 12 U.S.C. § 1831d, exempts federally insured, state-chartered banks and insured branches of foreign banks ("FDIC Banks") from compliance with state interest-rate caps. The Non-bank Interest Provision ("Provision") of the FDIC's Federal Interest Rate Authority Rule ("Rule") unlawfully extends this preemption of state-law rate caps to any entity—including a non-bank—that purchases loans from an FDIC Bank, allowing these non-banks to charge interest at rates that would otherwise violate state law.[1] 85 Fed. Reg. at 44,146-58 (codified as part of 12 C.F.R. § 331.4(e)).

The Provision violates the Administrative Procedure Act ("APA") in two independent ways: (1) the FDIC exceeded its statutory jurisdiction, authority, and limitations in issuing the Provision; and (2) the Provision is arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law. 5 U.S.C. § 706(2)(A), (C). The Provision conflicts with the unambiguous language of § 1831d (the statute it purports to interpret), exceeds the FDIC's authority, and impermissibly preempts state law. The FDIC failed to address important aspects of the problem that the Provision purportedly addresses, failed to analyze evidence in the record that contradicts the FDIC's basis for the Provision, and failed to acknowledge or explain the inconsistency between the Provision and the FDIC's stated position against rent-a-bank schemes that the Provision encourages. Plaintiffs are thus entitled to summary judgment on all claims.

BACKGROUND

I. State Interest-Rate Caps and FDIC Banks

State interest-rate caps (also called usury laws) have long played a central role in the financial protection of consumers and small businesses. *See Griffith v. Connecticut*, 218 U.S. 563, 568 (1910). Rate caps protect consumers from the debt traps of high-cost loans, scrupulous

[1] The portions of the Provision that state that interest that is permissible under section 27 shall not be affected by "a change in State law, [or] a change in the relevant commercial paper rate after the loan was made" are not at issue here. 12 C.F.R. § 331.4(e).

creditors (like landlords, suppliers, or auto lenders) from the threat of non-payment by debtors driven to insolvency by predatory lending, and taxpayers from the need to support families whose resources have been consumed by unaffordable interest payments. Administrative Record ("AR" or "Record")[2] [Dkt. No. 44] at AR 520-22, 561-63, 901-32; *see also* Compl. ¶¶ 2-3, 161, 164. For these reasons, most states cap the rates creditors may charge. *E.g.*, AR 635, 843. For example, New York imposes a 16% rate cap on most consumer loans and criminalizes charging interest above 25%. N.Y. Gen. Oblig. Law §§ 5-501, 5-511; N.Y. Banking Law § 14-a; N.Y. Penal Law §§ 190.40, 190.42; *see also* Cal. Fin. Code §§ 22303-06 (California rate caps).

Federal law, however, exempts banks subject to federal oversight from compliance with state rate caps; all other creditors must follow state law. The history of the banking system in the United States explains this preferential treatment. States have long chartered and regulated banks. With the passage of the National Bank Act ("NBA") in 1864, the federal government began to issue bank charters as well, creating national banks. 12 U.S.C. § 21 *et seq.* In the NBA, Congress granted national banks their preemptive privilege, placing them in the position of most-favored creditor, because of Civil War concerns that hostile states would discriminate against these newly formed national banks. *Beneficial Nat. Bank v. Anderson*, 539 U.S. 1, 10 (2003).

The banking chaos of the Great Depression prompted the 1933 creation of the FDIC. *See Senior Unsecured Creditors' Comm. of First RepublicBank Corp. v. FDIC*, 749 F. Supp. 758, 767 (N.D. Tex. 1990). Just as national banks are subject to oversight by the Office of the Comptroller of the Currency ("OCC"), Congress placed FDIC Banks under the regulatory supervision of the FDIC. *See* 12 U.S.C. 1820(d); *Bettersworth v. FDIC*, 248 F.3d 386, 389 n.2 (5th Cir. 2001).

Initially, FDIC Banks did not enjoy the statutory privilege of preempting state rate caps. But, as interstate banking activities grew in the 20th century, national banks' unique exemption from state interest-rate laws became an increasingly valuable privilege because it allowed national banks located in states with high (or no) rate caps to charge elevated interest rates to borrowers located in other states that impose lower caps. The Supreme Court has described this

[2] Relevant pages of the Administrative Record are identified throughout by the significant digits at the end of each Bates stamp. For example, "AR 614" refers to FDIC-AR-00000614.

practice as interest rate "exportation." *See Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 310-11, 314-15, 318-19 (1978).

In response to concerns that national banks' power to export high interest rates to low rate-cap states gave them a competitive advantage over FDIC Banks, Congress amended the FDIA, which sets forth the FDIC's authority and responsibilities, to place FDIC Banks on equal footing with national banks. *See* Depository Institutional Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 132 (1980) (codified at 12 U.S.C. § 1735f-7a). Section 521 of DIDA added § 27 of the FDIA, codified at 12 U.S.C. § 1831d. The terms of § 1831d largely mirror § 85, the NBA provision preempting state-law rate caps for national banks, and the FDIC has long taken the position that the two statutes must be interpreted *in pari materia*. *E.g.*, AR 211; *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 827 (1st Cir. 1992). Section 1831d states:

> In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks [*i.e.*, FDIC Banks] with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such [FDIC Bank] would be permitted to charge in the absence of this subsection, such [FDIC 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 . . . 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 [FDIC Bank] is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.

12 U.S.C. § 1831d(a). In recent decades, the second option—the rate permitted by the state in which the FDIC Bank is "located"—has governed in practice.

As with national banks, FDIC Banks' ability to export the interest rate permissible where they are located—regardless of the law applicable in the states where their borrowers live—is a valuable federal privilege. *See Greenwood Trust Co.*, 971 F.2d at 827. An FDIC Bank's "home state" (where the bank is located) is the state that issued its charter, but it may operate branches and make loans in "host states." 12 C.F.R. § 369.2. Unless loan approval, disbursal of loan proceeds, and communication of the decision to lend are all performed by the branch, an FDIC

Bank may charge interest at the rate allowed in its home state. AR 212. FDIC Banks chartered in states that allow high-cost loans can thus export those rates to host states with lower rate caps.

II. The Problem of Rent-A-Bank Schemes

Although Congress exempted only national banks and FDIC Banks from state rate caps, some non-bank lenders have formed sham "rent-a-bank" partnerships designed to evade state rate caps. In these "partnerships," a bank ostensibly originates the loans and sells them to a non-bank lender. The non-bank lender then charges interest in excess of state law, at the rate allowed in the bank's home state. These "partnerships" are known as "rent-a-bank" schemes because they frequently require little to no financial risk or involvement by the participating bank. *E.g.*, AR 543, 844. For example, FinWise Bank, an FDIC Bank chartered in Utah, has partnered with non-banks in at least thirty jurisdictions with rate caps to evade those otherwise-applicable rate caps; these non-banks charge interest in excess of 100% APR. AR 361 (Comment of Prof. Levitin); AR 903, 909, 912, 939 (Comment of Center for Responsible Lending, *et al.*).

III. *Madden v. Midland Funding* and Subsequent Industry Actions

As the FDIC acknowledges, the aim of the Provision is to overturn the Second Circuit's construction of § 85 of the National Bank Act—which the FDIC believes must be construed in the same way as § 1831d—in *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015). *See* AR 210, 213, 215, 220 (citing *Madden*); *id.* at 211 ("Because [§ 1831d] was patterned after section 85 and uses similar language, courts and the FDIC have consistently construed section 27 *in pari materia* with section 85." (citing *Greenwood Trust Co.*, 971 F.2d at 827)).

In *Madden*, the Second Circuit rejected non-bank debt buyers' argument that, because they bought loans from national banks, § 85 preemption allowed them to charge interest above New York's usury cap. 786 F.3d at 250-53. As the Second Circuit explained, § 85 grants national banks the privilege of asserting preemption against state rate caps—and so to charge interest in above what is permitted in the states where they do business. *Id.* at 250-52. "To apply NBA preemption to an action taken by a non-national bank entity, application of state law to that action must significantly interfere with a national bank's ability to exercise its power under the NBA." *Id.* (citing *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25, 33 (1996)). Application of state rate caps to non-bank debt buyers does not meet this standard: non-bank assignees act "solely on their own behalves, as the owners of the debt," not on behalf of national banks. *Id.* at 251. As the court observed, state regulation of what non-banks may charge does not inhibit national banks' power to charge and collect interest permitted under § 85, nor does it affect their power to make loans or interfere with the sale of those loans; at most, ordinary application of state law to non-banks could reduce the price that non-bank purchasers might be willing to pay national banks for their loans. *Id.* at 251. By contrast, the court observed that "extending those protections [of § 85] to third parties would create an end-run around usury laws for non-national bank entities." *Id.* at 252.

Despite the Second Circuit's straightforward application of the NBA's text and standard preemption principles, financial-industry interest groups coalesced around overturning *Madden* as a vehicle to expand interest rate preemption. The *Madden* defendants, supported by financial services industry interest groups, requested rehearing and, later, *certiorari*, warning that *Madden* "threatens to cause significant harm to [credit] markets, the banking industry, and the millions of families and businesses they serve." Br. of the Clearing House Association, *et al.* as *Amici Curiae* in Support of Reh'g and Reh'g *En Banc* 1, *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015), No. 14-2131-cv, 2015 WL 4153963; Petition for a Writ of Certiorari 3, *Midland Funding v. Madden*, 136 S. Ct. 2505 (2016), No. 15-610, 2015 WL 7008804. The Second Circuit denied rehearing and the Supreme Court denied *certiorari*. *See* Petition for a Writ of Certiorari, *Midland Funding v. Madden*, No. 15-610, 136 S. Ct. 2505, 2015 WL 7008804 (2016); Order Denying Pet. for Reh'g *En Banc*, *Madden v. Midland Funding*, No. 14-2131 (2d Cir. Aug. 12, 2015); AR 336-37. Despite the industry's warnings, no catastrophic consequences came to pass.

Unsatisfied, interest groups sought to overturn *Madden* and expand preemption under §§ 1831d and 85 via legislative action, to no avail. The proposed federal legislation would have extended preemption under § 1831d to non-bank loan buyers by amending § 1831d to state, "A loan that is valid when made as to its maximum rate of interest . . . shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party . . . ." S. 1642, 115th Cong. (2017-18), https://www.congress.gov/bill/115thcongress/senate-bill/1642; H.R. 3299, 115th Cong. (2017-18), https://www.congress.gov/bill/115th-congress/house-bill/13299. The Senate, however, let the bill expire. *See id*.

IV. THE FDIC'S RULEMAKING

In December 2019, the FDIC issued a proposed rule that includes the Non-bank Interest Provision, which, in relevant part, is nearly identical in substance to the failed S. 1642. *See* AR 51 (setting forth proposed rule). The Non-bank Interest Provision states:

> 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. Interest on a loan that is permissible under section 27 of the Federal Deposit Insurance Act shall not be affected by . . . the sale, assignment, or other transfer of the loan, in whole or in part.

Id.; AR 222 (adopting identical language in final Rule); 12 C.F.R. § 331.4(e). The FDIC received more than fifty comments from "consumer advocates [that] were generally critical of the proposed rule" and from "financial services trade associations, depository institutions, and non-bank lenders [that] expressed support for the proposed rule." AR 214.

The FDIC's rulemaking followed similar action by the OCC, which administers the National Bank Act and regulates national banks. *See* OCC, *Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred* ("OCC Rule"), 85 Fed. Reg. 33,530-36 (June 2, 2020).[3] Like the OCC Rule, which extended the reach of preemption under § 85 to any entity that buys loans from a national bank, the Provision extends the reach of § 1831d to any entity that buys loans from an FDIC Bank. *Id.* While the FDIC's Rule addresses other topics not at issue in this litigation, its Non-bank Interest Provision is substantively identical to the OCC Rule. *Id.* at 33,536 ("Interest on a loan that is permissible under 12 U.S.C. 85 shall not be affected by the sale, assignment, or other transfer of the loan"); *see also* AR 218 (making non-substantive change from proposed rule to be "more closely aligned with the text of the OCC's regulation").

On June 25, 2020, the FDIC's Board of Directors adopted the final Rule by a divided 3-1 vote; Director Martin J. Gruenberg dissented, warning that the Provision could enable rent-a-bank schemes. AR 226-27 ("[T]he practical import of today's rulemaking is to further insulate high-

[3] Several of the plaintiff States in this action have challenged the OCC Rule under the APA. *See California v. OCC*, Case No. 4:20-cv-05200-JSW.

cost loans made through these very [rent-a-bank partnerships] from legal challenge."). On July 22, 2020, the FDIC published the Rule, which took effect on August 21, 2020. AR 210-22.

LEGAL STANDARD

"Summary judgment . . . serves as the mechanism for deciding, as a matter of law, whether the agency action is supported by the administrative record and otherwise consistent with the APA standard of review." *Tolowa Nation v. United States*, 380 F. Supp. 3d 959, 963 (N.D. Cal. 2019). "In other words, the district court acts like an appellate court, and the entire case is a question of law." *Id.* (quotation marks omitted).

"The Court must first review the construction of the . . . [a]ct giving the [agency] discretion to operate" and must set aside any interpretation unsupported by the "unambiguously expressed intent of Congress." *Sierra Club v. Pruitt*, 293 F. Supp. 3d 1050, 1057 (N.D. Cal. 2018). It must "hold unlawful and set aside agency action" found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"; "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right"; or "without observance of procedure required by law[.]" 5 U.S.C. § 706(2)(A), (C), (D). "An agency rule is arbitrary and capricious when the agency 'has relied on factors which Congress has not intended it to consider,' 'entirely failed to consider an important aspect of the problem,' 'offered an explanation for its decision that runs counter to the evidence before the agency,' 'or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.'" *Tolowa Nation*, 380 F. Supp. 3d at 963 (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

ARGUMENT

I. THE PROVISION IS CONTRARY TO THE UNAMBIGUOUS LANGUAGE OF § 1831D, EXCEEDS THE FDIC'S AUTHORITY, AND IMPERMISSIBLY PREEMPTS STATE LAW.

As part of its congressionally granted authority to regulate FDIC Banks, the FDIC is authorized to construe the statutes it administers. In promulgating the Non-bank Interest Provision, however, the FDIC construed § 1831d in a manner that conflicts with the statute's plain language. The FDIC has not filled gaps or clarified ambiguity in the statute, but instead expanded its interest-rate privilege beyond FDIC Banks to non-banks that buy their loans. The FDIC has also expanded its own authority, beyond what Congress granted it, by purporting to dictate the interest rates that non-FDIC Banks can charge. By allowing those non-banks to disregard state usury laws, the Provision impermissibly preempts those state laws. The Provision thus violates the APA and must be set aside. 5 U.S.C. § 702(2)(C).

A. The Provision Conflicts with the Plain Language of § 1831d.

Congress limits an agency's authority to construe the statutes it administers. An agency may not alter the regulatory landscape if "Congress has supplied a clear and unambiguous answer to the interpretive question at hand." *Pereira v. Sessions*, 138 S. Ct. 2105, 2113 (2018). "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.*

The plain language of § 1831d demonstrates it applies to FDIC Banks—and no one else. The ability to export interest rates applies only to FDIC Banks: "**State bank[s] or [] insured branch[es] of a foreign bank** [*i.e.*, FDIC Banks] may . . . take, receive, reserve, and charge on any loan . . . interest at . . . the rate allowed by the laws of the State, territory, or district where **the bank** is located . . . ." 12 U.S.C. § 1831d(a) (emphasis added). Section 1831d's stated purpose applies only to FDIC Banks: "In order to prevent discrimination against [FDIC Banks] with respect to interest rates . . . ." *Id.* Section 1831d's remedies provision for interest overcharges likewise applies only to FDIC Banks: it allows recovery of "an amount equal to twice the amount of the interest paid from such State bank or such insured branch of a foreign branch taking, receiving, reserving, or charging such interest." *Id.* § 1831d(b). These provisions function together. To effectuate Congress's purpose to protect FDIC Banks from interest-rate discrimination, FDIC Banks, and only FDIC Banks, can assert the statute's benefits of interest-rate exportation, and are subject to the statute's consequences if they overcharge.

Recognizing this plain text, courts have held that § 1831d unambiguously applies only to FDIC Banks. As the Third Circuit has stated, § 1831d "appl[ies] only to . . . state chartered banks, not to non-bank loan purchasers" of loans. *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 296 (3d Cir.

2005). Other courts have held the same. *E.g.*, *Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134, 1144-45 (D. Colo. 2018) (§ 1831d does not regulate interest "that may be imposed by a non-bank, including one which later acquires or is assigned a loan made or originated by a state bank" and does not "state any purpose with regard to institutions other than federally-insured banks"); *Meade v. Marlette Funding LLC*, No. 17-cv-00575, 2018 WL 1417706, at *3 (D. Colo. Mar. 21, 2018) (citing cases that conclude that § 1831d "does not apply to non-bank entities"); *West Virginia v. CashCall, Inc.*, 605 F. Supp. 2d 781, 785 (S.D. W. Va. 2009) ("The FDIA does not apply to non-bank entities.").

The unambiguous nature of § 1831d is also supported by courts that have held that § 85 of the NBA only applies to national banks because, as the FDIC acknowledges, § 85 and § 1831d must be read *in pari materia*. As § 1831d does for FDIC Banks, § 85 allows national banks to "take, receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85. And like § 1831d(b), § 86, the exclusive remedies provision for violations of § 85, provides remedies only against national banks. 12 U.S.C. § 86 (imposing a penalty "twice the amount of the interest . . . from the association [*i.e.*, national bank] taking or receiving the same"). The Second and Third Circuits have thus held that § 85 applies only to banks, not to non-bank assignees. *In re Cmty. Bank of N. Va.*, 418 F.3d at 296 ("Sections 85 and 86 of the NBA and [§ 1831d] apply only to national and state chartered banks, not to non-bank purchasers" of their loans); *Madden*, 786 F.3d at 250 (holding that NBA does not allow assignees of national bank's loans to charge interest at rate permitted by state where assignor national bank is located). Courts have similarly held that § 85 applies only when a bank is the real party in interest charging interest on a loan. *E.g.*, *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, 1202 (N.D. Cal. 2012) (denying non-bank's motion to dismiss on NBA preemption grounds because "it is not clear whether or to what extent [the national bank] retained any significant stake in or control over [the] loan"); *Flowers v. EZPawn Okla., Inc.*, 307 F. Supp. 2d 1191, 1205 (N.D. Okla. 2004) (§ 85 did not apply because non-bank partner "exerts ownership and control over these loans . . . carries out all interaction with the borrowers, accepts the ultimate credit risk, collects and pockets virtually all of the finance charges and fees, and owns and controls the branding of the loans"). Indeed, the Second Circuit held that to extend rate-cap preemption to non-bank buyers "would create an end-run around usury laws for non-national bank entities." *Madden*, 786 F.3d at 252.

Contrary to § 1831d's limitation to FDIC Banks, the Provision impermissibly extends § 1831d's scope to any purchaser of loans originated by FDIC Banks. The FDIC claims the Provision addresses "the permissibility of interest under section 27 [§ 1831d]" after "the sale, assignment, or other transfer of [a] loan" originated by an FDIC Bank. AR 210. In effect, the FDIC rewrites § 1831d by adding entities that enjoy the privilege of preemption, as shown in the following bracketed and italicized terms to § 1831d:

> . . . such State bank or such insured branch of a foreign bank [*or the buyer, assignee, or transferee of any loan made by such bank*] may . . . take, receive, reserve, and charge on any loan . . . interest . . . at the rate allowed by the laws of the State, territory, or district where the bank is located . . . .

This re-writing of § 1831d is not allowed. "[A]n agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate," *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 328 (2014). Because § 1831d's language plainly applies to FDIC Banks—and not, as the FDIC would have it, also to buyers of an FDIC Bank's loans—the Provision is contrary to the statute and beyond the FDIC's authority to promulgate. *See Pangea Legal Servs. v. U.S. Dep't of Homeland Sec.*, No. 20-cv-07721, 2020 WL 6802474, at *1 (N.D. Cal. Nov. 19, 2020) (invalidating rule because it "both contradicts Congress's intent and exceeds the authority Congress gave to the executive agencies").

B. Congress's Choice To Limit § 1831d Preemption to FDIC Banks Does Not Create Any "Ambiguity" or "Statutory Gap" for the FDIC To Fill.

Section 1831d is limited to FDIC Banks, and the FDIC's attempts to conjure ambiguities or gaps in the statute fail. All statutory language contains an infinite number of "gaps"; any piece of language inherently speaks to certain issues but is silent on others. Not every such silence creates a statutory gap that allows agency action. As a practical matter, "[i]n every challenge to agency action, 'the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*.'" *Merck & Co. v. U.S. Dep't of Health & Human Servs.*, 385 F. Supp. 3d 81, 88 (D.D.C. 2019) (quoting *City of Arlington, Tex. v. FCC*, 569 U.S. 290, 297 (2013)) (emphasis in *Merck*), *aff'd*, 962 F.3d 531 (D.C. Cir. 2020).

Notwithstanding § 1831d's clarity, the FDIC claims that the Provision fills two purported "statutory gaps" in § 1831d: a gap as to when the "validity" of a loan's interest rate should be determined and a gap as to the "implicit" right of an FDIC Bank to transfer to loan purchasers the interest rate it charged on a loan. AR 210. Both arguments fail.

1. There Is No Ambiguity or Statutory Gap As to When the Validity of a Loan's Interest Rate Should Be Assessed.

The FDIC claims that § 1831d "does not state at what point in time the validity of the interest rate should be determined to assess whether a State bank is taking or receiving interest in accordance with section 27 [§ 1831d]." AR 210. The Provision, according to the FDIC, fills this purported gap by mandating that "the permissibility of interest rate under [1831d] must be determined when the loan is made, and shall not be affected by . . . the sale, assignment, or other transfer of the loan." AR 210.[4]

The FDIC's framing of the problem with § 1831d (*i.e.*, uncertainty about the legality of a loan's interest rate after it is made) and the solution it has come up with (*i.e.*, determine legality at the loan's origination) misleadingly suggest that § 1831d applies to certain *loans*—that is, loans issued by FDIC Banks). But § 1831d does not apply to certain *loans*; rather, it applies to certain *entities*—FDIC Banks—and gives those entities (and only those entities) the privilege of charging interest in excess of otherwise applicable state law. Once those loans are no longer held by FDIC Bank, that exception ceases to exist. *See* Section I.A.

[4] In its discussion of this purported gap, the FDIC expresses concern about "[s]ituations . . . 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." AR 210. To address this "gap," the Provision states that the permissibility of an interest rate under § 1831d is not "affected by a change in State law." *Id.* This section of the Provision is outside the scope of Plaintiffs' motion.

The FDIC cannot transform § 1831d's interest-rate privilege, which Congress granted by statute only to FDIC Banks, into a transferrable right under the guise of providing certainty. The sale of property does not include the transfer rights statutorily conferred on the seller. Credit unions are exempt from federal income tax, but other entities do not become tax exempt when they buy a credit union's loans. *See* 26 U.S.C. § 501(c)(14)(A). A licensed driver may sell her car, but the new owner cannot legally drive it if he does not have his own license. *E.g.*, Cal. Veh. Code § 12500. The right to assert preemption under § 1831d is determined based on the holder of the loan; the statute is not rendered ambiguous and does not contain a statutory gap just because the legality of a loan's interest rate must be reassessed when the loan is transferred from an entity that enjoys preemption privileges to one that does not. In § 1831d, Congress permitted an FDIC Bank to charge a higher interest rate than otherwise permitted by state law, but once it sells that loan, that privilege that Congress afforded to the FDIC Bank no longer applies and a non-bank purchaser cannot exceed state rate caps.

To bolster its claims about the continuing validity of a loan's interest rate, the FDIC describes the Provision as "consistent with . . . common law doctrines such as the 'valid when made' . . . rule[]"). AR 213. The FDIC disclaims reliance on this doctrine, however, for good reason. AR 215. It is a newly invented theory that appears to rely on a misreading of pre-Civil War, inapposite caselaw. *See, e.g.*, AR 355-56; AR 213 (citing *Nichols v. Fearson,* 32 U.S. 103, 109 (1833); *Gaither v. Farmers' & Mechs.' Bank of Georgetown,* 26 U.S. 37, 43 (1828); and *FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. Unit B 1981) (citing *Nichols*)).[5] This theory provides no support for the Provision.

[5] *Nichols* and *Gaither* concern the now-obsolete law of transferable notes, which were often traded multiple times at discount. These cases merely hold that if a lender originates a loan at an interest rate lower than the relevant rate cap and then sells the loan for less than the original loan amount, the loan does not become usurious just because the total amount owed constitutes a percentage that would exceed the rate cap if calculated based on the discounted-sale price rather than on the original loan amount. *Nichols*, 32 U.S. at 106-11, *Gaither*, 26 U.S. at 41-45. In other words, whether the interest rate is usurious is correctly calculated based on the rate the borrower must pay in relation to the principal amount borrowed, not based on the rate of return realized by an assignee in relation to the cost it invests to purchase the loan.

2. There Is No Ambiguity or Statutory Gap as to the Right of FDIC Banks To Transfer Loans Not Subject to an Interest Rate Cap.

The FDIC claims that a gap exists because § 1831d "expressly gives banks the right to make loans at the rates permitted by their home States, but does not explicitly list all the components of that right," namely, the purported "implicit component" to assign loans to a non-bank at the FDIC Bank's permissible interest rate. AR 210. According to the FDIC, the Provision makes that "implicit component" explicit. AR 213. In essence, the FDIC purports to clarify that the express preemption right that Congress granted to FDIC Banks includes an implicit right to assign their preemption right to non-bank purchasers of their loans.

Section 1831d does not include an implicit right of FDIC Banks to sell their exemption from state interest-rate laws when they sell their loans. While contractual rights may, under contract law, be assigned to a loan purchaser, § 1831d's right to exemption from state usury law is not a contractual right; it is a statutory right that Congress granted only to FDIC Banks. 12 U.S.C. § 1831d. As former OCC Comptroller John D. Hawkes, Jr., explained, preemption "is an inalienable right of the bank itself" and is "not a commodity that can be transferred for a fee to nonbank lenders." AR 844, 857. There is no reason to believe Congress would have conflated statutory rights with contractual rights or that it intended to "imply" that § 1831d's exemption for FDIC Banks could be sold, as part of a loan contract, to other entities.

C. The FDIC's Interpretation of § 1831d Is Controverted by Language that Congress Adopted in a Simultaneously Drafted Statute in the Same Legislation

The Provision's interpretation of § 1831d is also undermined by comparison to language that Congress used in a related provision in the same Act. At the same time Congress drafted § 1831d, which applies preemption to specified *entities*, it drafted 12 U.S.C. § 1735f-7a, which applies preemption to specified *loans*.

The "contrast between the language used" in two different standards in the same Act that "the same Congress simultaneously drafted" "certainly indicate[s] that Congress intended the two standards to differ." *INS v. Cardoza-Fonseca*, 480 U.S. 421, 432 (1987). "[W]hen 'Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion . . . .'" *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 452 (2002) (citation omitted).

Congress knows how to express its intent that interest-rate preemption will apply to a category of loans. At the same time and as part of the same Act, Congress passed § 1831d (§ 521 of DIDA) and § 1735f-7a (§ 501 of DIDA). Unlike § 1831d, which preempts state rate caps for FDIC Banks, § 1735f-7a preempts state rate caps for "any loan, mortgage, credit sale, or advance" secured by a first-lien mortgage on a residential property. 12 U.S.C. § 1735f-7a. By granting preemptive status to loans, rather than specific entities holding them (as it did in § 1831d), Congress made clear its intent that transfer would not subject the holders of these first-lien mortgage loans to state rate caps. *See* S. Rep. No. 906-368, at 19 (1979).

Congress's choice to exempt a class of *loan* from state rate caps in one section of DIDA (§ 1735f-7a) and a class of *entity* in another (§ 1831d) indicates that Congress intended the two provisions to operate differently. This confirms that Congress intended § 1831d to grant preemptive status only to FDIC Banks and that preemption ceases once a bank no longer holds a loan. Because the Provision does what Congress deliberately chose not to do in § 1831d, it must be set aside.

D. The FDIC Lacks the Authority To Regulate Non-banks.

The FDIC does not have congressional authority to issue the Provision. The Provision regulates the interest rates that non-FDIC Banks can charge on loans bought from an FDIC Bank. Congress, however, delegated to the FDIC the authority to regulate FDIC Banks only.

"An agency's power to promulgate legislative regulations is limited to the authority delegated to it by Congress." *Amalgamated Transit Union v. Skinner*, 894 F.2d 1362, 1368 (D.C. Cir. 1990) (quotation marks omitted). "[A]n agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986). Agency rulemaking violates the APA if the agency exceeded the bounds of its statutory authority. *E.g.*, *Merck*, 385 F.

Supp. 3d at 88.

Congress, which established the FDIC to insure banks' deposits and ensure the safety and soundness of their operations, gave the FDIC authority over FDIC Banks. 12 U.S.C. § 1811. The FDIC's purported sources of authority do not support its attempted regulatory expansion beyond FDIC Banks. AR 222 (citing 12 U.S.C. §§ 1831d, 1819(a)(Tenth), and 1820(g) as "authority" for the Rule). As discussed above, § 1831d is limited to FDIC Banks. *See* Section I.A. The two general rulemaking provisions that the FDIC cites merely give it the authority to make rules as necessary to carry out its responsibilities to regulate FDIC Banks. *See FDIC v. New York*, 718 F. Supp. 191, 196 (S.D.N.Y. 1989) (holding that § 1819 "does nothing more than give the FDIC power to exercise all other powers specifically granted to it by other statutory provisions, and those incidental powers necessary to carry out a previously granted power"), *aff'd*, 928 F.2d 56 (2d Cir. 1991); *Lambert v. FDIC*, 847 F.2d 604, 606 (9th Cir. 1988) (stating that "[t]he FDIC is an agency created by the Federal Deposit Insurance Act . . . to regulate banks" (citing 12 U.S.C. §§ 1811-1831d)). Nowhere in these statutes did Congress expressly confer on the FDIC the authority to regulate non-banks.

Congress also did not implicitly grant the FDIC such authorization. "An agency's general rulemaking authority plus statutory silence does not . . . equal congressional authorization." *Merck*, 385 F. Supp. 3d at 92. General rulemaking provisions, like § 1819 here, "do not supply an agency '[c]arte blanche authority' to promulgate rules on any matter relating to its enabling statute." *Id.* (quoting *Citizens to Save Spencer Cty. v. EPA*, 600 F.2d 844, 873 (D.C. Cir. 1979)). Nor is "the mere absence of an express statutory restriction . . . a blank check to regulate on any subject matter that might conceivably advance a legislative purpose." *Id.* at 94; *see also id.* at 92 (citing *Am. Bus Ass'n v. Slater*, 231 F.3d 1, 9 (D.C. Cir. 2000) (Sentelle, J., concurring) ("Hence if Congress wishes to deny an agency a given power, it need not expressly restrict the agency; it is enough for Congress simply to decline to delegate power. . . . In order for there to be an ambiguous grant of power, there must be a grant of power in the first instance.")); *Railway Labor Execs.' Ass'n v. Nat'l Mediation Bd.*, 29 F.3d 655, 671 (D.C. Cir.) ("Were courts to *presume* a delegation of power absent an express *withholding* of such power, agencies would enjoy virtually limitless hegemony, a result plainly out of keeping with *Chevron* and quite likely with the Constitution as well." (emphasis in original)), *amended*, 38 F.3d 1224 (D.C. Cir. 1994). Just as in *Merck*, all the FDIC has here is "general rulemaking authority plus statutory silence," which is insufficient to establish congressional authorization.

The FDIC claims that the Provision "would not regulate non-banks," *see, e.g.*, AR 214. But the Provision does exactly that. As the FDIC acknowledges, under the Provision, "[a]n assignee can enforce [a] loan's interest-rate terms to the same extent as the assignor." AR 219. The FDIC exceeded its authority in presuming to grant non-bank assignees the power to "enforce" interest-rate terms that violate state usury laws.

E. The Provision Impermissibly Preempts State Law.

The FDIC exceeded its authority in construing § 1831d as preempting state rate caps that would otherwise apply to non-banks. Congress made its intent plain to limit preemption to FDIC Banks. Even if the statute were ambiguous, the FDIC's interpretation fails to overcome the presumption against preemption in areas of the law traditionally regulated by states, and its construction is not entitled to deference.

When addressing preemption, courts start "with the assumption that the historic police powers of the States are not to be superseded by [federal law] unless that was the clear and manifest purpose of Congress." *Altria Grp., Inc. v. Good*, 555 U.S. 70, 77 (2008) (quotation marks and alterations omitted). This presumption against preemption "applies with particular force when Congress has legislated in a field traditionally occupied by the States," *id.*, such as consumer protection law, *Aguayo v. U.S. Bank*, 653 F.3d 912, 917 (9th Cir. 2011); interest-rate caps, *Griffith*, 218 U.S. at 569; and the regulation of state-chartered banks, *In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.*, 966 F. Supp. 2d 1018, 1025 (C.D. Cal. 2013). In such situations, "when the text of a pre-emption clause is susceptible of more than one plausible reading, courts ordinarily accept the reading that disfavors pre-emption." *Altria Grp.*, 555 U.S. at 77 (quotation marks omitted). The presumption against preemption applies to agency action that extends the reach of a preemption statute. *Massachusetts v. U.S. Dep't of Transp.*, 93 F.3d 890, 896 (D.C. Cir. 1996) (invalidating agency's reading of statute "[i]n light of the powerful and well-established presumption against extending a preemption statute to matters not clearly addressed in the statute in areas of traditional state control").

Section 1831d's preemption provision is unambiguous in its purpose: "to prevent discrimination against [FDIC Banks] . . . with respect to interest rates." 12 U.S.C. § 1831d(a). It is equally unambiguous in its effect: if the interest rate the FDIC Bank charges is permitted by § 1831d but would otherwise be prohibited by state law, the FDIC Bank may charge the rate permitted by § 1831d "notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section." *Id.* In § 1831d, Congress did not express an intent to protect buyers of FDIC Banks loans from discrimination, and, consequently, did not extend preemption to those buyers.

Even if § 1831d were ambiguous and the FDIC's interpretation plausible, the Court must accept the reading that disfavors preemption. The only practical effect of the Provision is to extend § 1831d's preemptive authority so that it protects not just FDIC Banks from interest-rate discrimination, as Congress intended, but also non-bank buyers of FDIC Banks' loans. Indeed, the FDIC admits that the Provision "address[es] uncertainty regarding the applicability of State law interest rate restrictions to State banks and other market participants." AR 219. The Provision would "eviscerate" state rate caps, "threatening federalism's careful balance and overturning more than two centuries of state regulation of lending activity," by emboldening non-bank lenders to funnel loans through FDIC Banks. AR 843-44. The FDIC's construction must yield to the reasonable non-preemptive interpretation that § 1831d preemption is, as § 1831d states, limited to FDIC Banks.

F. The FDIC Lacks the Authority To Interpret State Law.

The FDIC wrongly claims that it has the authority to issue the Provision based on FDIC Banks' "power to sell or transfer loans." AR 213. But as the FDIC acknowledges, the power to sell or transfer loans is granted by state law, not federal law. *Id.*; *see also, e.g.*, Cal. Fin. Code § 109; 205 Ill. Comp. Stat. Ann. 5/3; N.Y. Banking Law § 961(1). As state-chartered institutions, FDIC Banks rely primarily on state law for their existence and operating authorities, including the authority to make and sell loans. The FDIC's rulemaking authority does not extend to the interpretation of state law; it is limited to the statutes the FDIC administers. 12 U.S.C. §§ 1819(a), 1820(g). Section 1831d has nothing to do with the power to sell (or even make) loans. The FDIC cannot transform a state-law power to sell loans into a federal power to include the seller's preemption privilege as part of the sale.

Even if the FDIC did have the authority to construe state law—and it does not—it lacks the expertise to do so and thus the Provision would not be entitled to any deference. *See, e.g.*, *Sandoval v. Sessions*, 866 F.3d 986, 988 (9th Cir. 2017) ("We do not defer to an agency's interpretations of state law . . . ."); *Bank of N. Shore v. FDIC*, 743 F.2d 1178, 1185 (7th Cir. 1984) (noting that "the FDIC may not independently determine state law").

The FDIC also fails to identify the state laws that the Provision purports to interpret, let alone explain how they support the Provision. Each state has its own laws governing FDIC Banks' sale of loans. Even if the FDIC were authorized to issue binding interpretations of state law, it would have been required to discuss its analysis of the states' laws and how they authorize the Provision.

II. THE PROVISION IS ARBITRARY AND CAPRICIOUS.

In issuing the Provision, the FDIC failed to (1) consider important aspects of the problem that the Provision purportedly seeks to address, (2) provide the minimal level of analysis required by the APA, instead relying on explanations for its decision that run counter to the evidence in the Administrative Record, and (3) acknowledge and explain the reversal of policy positions. The Provision is therefore "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

A. The FDIC Failed To Consider the Provision's Facilitation of "Rent-a-Bank" Schemes, the True Lender Doctrine, and the Regulatory Vacuum the Provision Creates, As It Was Required To Do.

Agency action is lawful only if it rests on "a consideration of the relevant factors" and must be set aside if the agency "entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 42-43; *see also E. Bay Sanctuary Covenant v. Barr*, 964 F.3d 832, 854 (9th Cir. 2020) (rule limiting asylum access that did not exempt unaccompanied minors was arbitrary and capricious because agency did not address these minors' special vulnerability).

The agency must address all important aspects of the Rule—the problem that, in the agency's view, the Rule solves, as well as the problems that it would create—and it must do so meaningfully. *See id.* at 861 ("the agencies were required to give the safety issues [of unaccompanied minors] more consideration than a single paragraph in the rulemaking that does not meaningfully engage with the critical question") (Miller, J., concurring in part and dissenting in part).

The Provision's facilitation of rent-a-bank schemes, the application of the true lender doctrine, and the Provision's creation of a regulatory vacuum are "important aspect[s] of the problem" of interest-rate preemption transferability that the FDIC was legally bound to consider. Because the FDIC failed to meaningfully address these factors, the Provision must be set aside.

First, the Record is replete with evidence showing that the Provision will facilitate rent-a-bank schemes and result in borrower harm from predatory loans. *See, e.g.*, AR 634-35 (Comment of 14 State Treasurers) (the Provision "would severely undermine both state law and Bush-era banking guidance on rent-a-bank arrangements"); AR 343-44 (Comment of East Bay Community Law Center); AR 561-63 (Comment of AARP). In rent-a-bank schemes, non-bank lenders seek to evade state rate caps by "partnering" with banks that serve as mere pass-throughs for high-cost loans. *See, e.g.*, AR 844 (Comment of Sen. Brown, *et al.*). As many commenters emphasized, these schemes rely on precisely the type of transaction that the Provision seems to allow: a bank originates a loan, the bank sells that loan to the "partner" non-bank, and the non-bank continues charging interest at a rate that violates state usury laws. For instance, commenters cited the announcements of several lenders planning to use "bank partnerships" to evade state rate caps, and provided examples of individuals and families harmed by lenders who have announced their intentions to engage in "rent-a-bank" partnerships that the Provision facilitates. *E.g.*, AR 901-32 (Comment of Center for Responsible Lending, *et al.*); AR 545-48 (Comment of Consumer Reports); AR 592-95 (Comment of Hope Enterprise Corp.); AR 843-47 (Comment of Sen. Brown, *et al.*); AR 1031-33 (Comment of Better Markets, Inc.).

Instead of undertaking the analysis the APA requires, the FDIC denies that the Provision will facilitate "rent-a-bank" schemes or other forms of predatory lending. *See, e.g.*, AR 217 (claiming, in response to comments that the Provision would facilitate rent-a-bank schemes, "The proposed rule would not exempt State banks or non-banks from State laws and regulations . . . [or] address or affect the broader licensing or regulatory requirements that apply to banks and non-banks under applicable State law."). The FDIC further claims that its rulemaking is not the appropriate venue to address predatory lending concerns and is not meant to prohibit state law remedies for state rate-cap violations. *Id.*

The FDIC's denials do not meet the level of analysis that the APA requires. The FDIC was required to meaningfully address evidence that the Provision will likely facilitate rent-a-bank schemes and to explain how it has taken the likely facilitation of these schemes into account. Instead, it dismissed those concerns, and in fact all predatory lending concerns, as outside the scope of its rulemaking. The FDIC's decision to turn a blind eye to the problem that the Provision itself exacerbates, rather than to address it, is arbitrary and capricious. *See E. Bay Sanctuary Covenant*, 964 F.3d at 854.

Second, the FDIC failed to meaningfully engage with the true lender issue, despite numerous comments asking it to do so and despite this issue's significance to interest-rate preemption transferability. *See, e.g.*, AR 638 (Comment of Nat'l Assoc. of Consumer Credit Administrators); AR 356-57 (Comment of Prof. Levitin); AR 567-68 (Comment of Reinvestment Partners). The true lender doctrine is a product of state law. As modern predatory lenders have invented new forms of rent-a-bank schemes, courts have applied the true lender doctrine, which considers various factors to determine whether the bank that purports to make a loan or the non-bank partner is the "true or de facto lender" of the loan. *Consumer Financial Protection Bureau v. CashCall*, No. CV 15-7522, 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016) (applying the "predominant economic interest" standard); *see also Easter v. Am. W. Fin.*, 381 F.3d 948, 957 (9th Cir. 2004) (the "touchstone for decision" was which party was "placing their own money at risk").

Although the true lender doctrine's applicability to loan sales potentially covered by the Provision bears directly on the Provision's facilitation of rent-a-bank schemes, the FDIC refused to meaningfully address this issue. *E.g.*, AR 210 (Provision does "not address the question" of "which entity is the 'true lender'"), AR 216 (true lender issue is "not so intertwined" with Provision that it must be addressed in the rulemaking). Instead, it determined that the policy implications of applying the true lender doctrine, while worthy of consideration, "should not delay [its] rulemaking." The FDIC's acknowledgement "that the text of the [Provision] cannot be reasonably interpreted to foreclose true lender claims," AR 217,[6] is insufficient, particularly given the Provision's encouragement of state-law evasion. The FDIC issued the Provision to resolve "uncertainty" about what interest rate a non-bank purchaser of FDIC Bank loans may charge. But by encouraging rent-a-bank schemes and refusing to address the true lender issue, the Provision increases uncertainty. The FDIC failed to consider how the Provision's encouragement of rent-a-bank schemes will increase the number and complexity of true lender disputes, how many purported loan sales would likely fall outside the Provision's scope due to true lender issues, and related issues raised by the interplay of the true lender doctrine and the Provision regarding interest rate preemption transferability. Accordingly, the Provision is arbitrary and capricious.

Third, the FDIC failed to consider that the Provision creates a regulatory vacuum for non-banks that overcharge interest on loans bought from an FDIC Bank. The FDIC would grant these non-banks the same right that § 1831d grants FDIC banks to ignore state rate caps and would immunize them from penalties for violating those state usury laws. However, the remedies provision for violations of § 1831d expressly applies only to FDIC Banks, not to non-bank loan buyers of FDIC Bank loans. 12 U.S.C. § 1831d(b) (allowing recovery "from such State bank or such insured branch of a foreign branch taking, receiving, reserving, or charging such interest"). This gap in oversight is exacerbated by predatory lenders' use of off-shore entities that purchase loans to charge and receive interest. *See, e.g.*, AR 360 (describing California lender's use of a Cayman Islands special-purpose vehicle to purchase assets from bank partners in a rent-a-bank scheme). The FDIC acted arbitrarily and capriciously in failing to address its creation of circumstances in which neither state nor federal law applies to these non-banks.

[6] Plaintiffs agree that the state law true lender doctrine applies when questions are raised as to who is the true lender of a loan, and that the Provision does not apply when state law deems a non-bank, not its FDIC Bank partner, to be the true lender. Many Plaintiffs in this case are currently challenging the OCC's unlawful effort to preempt the true lender doctrine with respect to national banks. *See* Complaint, *New York v. OCC*, No. 21-civ-57 (S.D.N.Y. Jan. 5, 2021).

B. The FDIC's Basis for the Provision Lacks Evidentiary Support and Ignores Contrary Evidence in the Record.

An agency rule is arbitrary and capricious when the agency "has offered an explanation for its decision that runs counter to the evidence before the agency." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. An agency, at the very least, "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." *Id.* Agency action based on "speculation . . . not supported by the record" is arbitrary and capricious. *Ariz. Cattle Growers' Ass'n v. U.S. Fish & Wildlife, Bureau of Land Mgmt.*, 273 F.3d 1229, 1244 (9th Cir. 2001).

The Provision purports to address market disruptions that the FDIC admits it has not observed. In support of the Provision, the FDIC repeatedly emphasizes the importance of loan sales from FDIC Banks to non-banks as "central to the stability and liquidity of the domestic loan markets" and asserts that the Provision will address "uncertainty" following *Madden* and "mitigate the potential for future disruption to the markets for loan sales and securitizations . . . and a resulting contraction in availability of consumer credit." AR 213, 219. However, the FDIC itself acknowledges 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." AR 220. Because *Madden* has not caused any significant problems for the Provision to mitigate, the FDIC necessarily admits that it "does not expect immediate widespread effects on credit availability" to result from the Provision. AR 219.[7] This lack of expected cause-and-effect between the Provision and the problem it purports to address underscores that the FDIC has not shown "a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43 (quotation marks omitted). Furthermore, the Record contains evidence that contradicts the very premise that state rate caps constrain bank liquidity or that selling loans with interest rates that exceed state rate caps is a material source of bank liquidity. *E.g.*, AR 353-54.

[7] Similarly, nearly five years after *Madden*, the OCC testified to Congress that capital and liquidity remained "near historic highs." AR 856 (quoting *Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions: Hearing Before the H. Comm. on Fin. Servs.*, 116 Cong. 3 (2019) (statement of Joseph M. Otting, Comptroller of the Currency)).

Instead of evidence, the FDIC offers only speculation as to *Madden*'s possible effects. *See* AR 216 (stating that loans in the Second Circuit "*may have been* directly affected by *Madden*" and FDIC Banks outside the Second Circuit "*might be* impaired in their ability to sell loans in the future" (emphases added); AR 220 (noting that *Madden* "rais[es] the *possibility* that future decisions will put further pressure on credit availability or securitization markets" (emphasis added)). In fact, the FDIC admits that it did not conduct or review any empirical studies. AR 215-16. While the final Rule makes a fleeting reference to two empirical studies about *Madden*'s impact, AR 219, the FDIC failed to discuss the studies' methods or results and to explain what, if any, role they played in its rulemaking. Without this discussion, the FDIC's reliance on these studies is arbitrary and capricious. *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. The FDIC's speculation, unsupported by the Record and counter to its own observations, is inadequate for APA purposes, rendering the Provision invalid.

C. The Provision Conflicts with the FDIC's Stated Position Against Rent-a-Bank Schemes.

"[A]n '[u]nexplained inconsistency' in agency policy is 'a reason for holding an interpretation to be an arbitrary and capricious change from agency practice.'" *Encino Motorcars v. Navarro*, 136 S. Ct. 2117, 2125-26 (2015) (quoting *Nat'l Cable & Telecommunications Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005)). When an agency departs from a previously held policy position, it "must at least display awareness that it is changing position and show that there are good reasons for the new policy." *Id.* (quotation marks omitted).

The Provision is inconsistent with the FDIC's stated position against rent-a-bank schemes. The FDIC has stated that it "view[s] unfavorably entities that partner with [an FDIC Bank] with the sole goal of evading a lower interest rate established [by state law]." AR 210-11; *see also* AR 44 (Notice of Proposed Rulemaking), 53 (Nov. 19, 2019 Statement by FDIC Chairman Jelena McWilliams), 563 (Comment of AARP, citing Nov. 16, 2015 FDIC payday-lending guidelines and stating that "institutions face increased reputation risks when they enter into certain arrangements with payday lenders, including arrangements to originate loans on terms that could not be offered directly by the payday lender"). The Provision, however, exempts all non-bank buyers of FDIC Banks' loans from state rate caps, which is the essence of rent-a-bank schemes, and facilitates such schemes. *See* Section II.A. The FDIC has not acknowledged or explained this inconsistency, and this "[u]nexplained inconsistency" renders the Provision arbitrary and capricious.

CONCLUSION

For the reasons stated above, the Non-bank Interest Provision violates the APA and Plaintiffs are thus entitled to summary judgment. 5 U.S.C. § 706(2)(A), (C).

Dated: April 22, 2021

Respectfully Submitted,

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IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

PEOPLE OF THE STATE OF CALIFORNIA, et al., Plaintiffs, **v.** **THE FEDERAL DEPOSIT INSURANCE CORPORATION**, Defendant.	Case No. 4:20-cv-05860-JSW **[PROPOSED] ORDER GRANTING PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND VACATING DEFENDANT'S RULE**

On August 6, 2021 at 9:00 a.m., the Court heard the Motion for Summary Judgment brought by Plaintiffs the People of the State of California, the District of Columbia, the People of the State of Illinois, the People of the Commonwealth of Massachusetts, the State of Minnesota, the State of New Jersey, the People of the State of New York, and the State of North Carolina (collectively, "Plaintiffs"), asking that that the Court hold unlawful and set aside a provision of Defendant the Federal Deposit Insurance Corporation's ("FDIC") Federal Interest Rate Authority Rule, codified as part of 12 C.F.R. § 331.4(e), that provides, "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. Interest on a loan that is permissible under section 27 of the Federal Deposit Insurance Act [12 U.S.C. § 1831d] shall not be affected by . . . the sale, assignment, or other transfer of the loan, in whole or in part." 85 Fed. Reg. 44,146-58 (July 22, 2020) ("Non-bank Interest Provision" or "Provision"). Having considered the Administrative Record [Dkt. No. 44], all papers filed in support of and in opposition to summary judgment, oral arguments of counsel, and all other pleadings and papers filed herein, the Court grants summary judgment in Plaintiffs' favor and vacates the Non-bank Interest Provision.

States have long used interest-rate caps to prevent predatory lending. Congress first gave federally chartered national banks the statutory privilege of state rate-cap preemption, allowing them to charge interest rates in excess of state law. 12 U.S.C. § 85. To ensure that federally insured, state-chartered banks and insured branches of foreign banks ("FDIC Banks") could compete on a level playing field with national banks, Congress later gave FDIC Banks this same statutory privilege. 12 U.S.C. § 1831d. The Provision unlawfully extends preemption of state rate caps to any entity—bank or not—that buys loans from an FDIC Bank. 85 Fed. Reg. at 44,146-58.

First, the FDIC lacked authority to issue the Provision. This interpretation conflicts with the unambiguous statutory text, which preempts state rate caps in favor of FDIC Banks alone. 12 U.S.C. § 1831d; *see, e.g.*, *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 296 (3d Cir. 2005). Notwithstanding Defendant's claims, federal law does not delegate authority to the FDIC to extend preemption to non-banks or to interpret the state law right of FDIC Banks to transfer loans. *See* 12 U.S.C. §§ 1819(a), 1820(g), 1831d; *Sandoval v. Sessions*, 866 F.3d 986, 988 (9th Cir. 2017). Comparison with a simultaneously drafted provision in the same legislation confirm that Congress did not intend to extend § 1831d beyond FDIC Banks. 12 U.S.C. § 1735f-7a. The Provision also impermissibly preempts state law. *See Altria Grp., Inc. v. Good*, 555 U.S. 70, 77 (2008); *Massachusetts v. U.S. Dep't of Transp.,* 93 F.3d 890, 896-97 (D.C. Cir. 1996).

Second, the FDIC's action is arbitrary and capricious. The agency failed to address important aspects of the problem its Provision purports to address, including the Provision's facilitation of "rent-a-bank" schemes and its creation of a regulatory vacuum. The evidence in the Administrative Record also undermines the FDIC's alleged basis for the Provision, and the Provision conflicts with the FDIC's stated position against predatory lending. *See Motor Vehicle*

Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983); *Encino Motorcars v. Navarro*, 136 S. Ct. 2117, 2125-26 (2015).

For these reasons, the Court finds that the Provision is arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law; is in excess of statutory jurisdiction, authority, and limitations, and short of statutory right; and constitutes agency action taken without observance of procedure required by law. The Provision thus violates the Administrative Procedure Act, 5 U.S.C. § 706(2), and must be set aside.

Good cause appearing therefore, **IT IS HEREBY ORDERED THAT:**

1. Plaintiffs' Motion for Summary Judgment is **GRANTED**; and
2. The Non-bank Interest Provision, 85 Fed. Reg. 44,146-58 (July 22, 2020) (codified as part of 12 C.F.R. § 331.4(e)), is **VACATED**.

Dated: By: ______________________________
United States District Judge Jeffrey S. White