A Comparison of the Most Favored Lender and Exportation Rights of National Banks, FSLIC-Insured Savings Institutions, and FDIC-Insured State Banks

By Jeffrey I. Langer and Jeffrey B. Wood*

Jeffrey I. Langer is Senior Counsel with Household Finance Corporation in Prospect Heights, Illinois. He is a member of the Illinois bar, the American Bar Association Consumer Financial Services Committee, and the Chicago Bar Association Consumer Credit Committee. Mr. Langer has co-authored an article entitled "Creditor List Screening Practices: Certain Implications under the Fair Credit Reporting Act and the Equal Credit Opportunity Act," which is being published in the May, 1988 issue of *The Business Lawyer*. He also has lectured extensively on interstate lending matters. Mr. Langer is a graduate of Northwestern University School of Law (J.D. 1980) and the University of Illinois, Urbana-Champaign.

Jeffrey B. Wood is Counsel with Household Finance Corporation in Prospect Heights, Illinois. A member of the Illinois Bar, he is a graduate of Northwestern University School of Law (J.D. 1984) and the College of William and Mary. He has lectured on real estate law and mortgage lending for the Institute of Financial Education.

Consumer credit transactions today are increasingly conducted across state lines. Interstate lending enables financial institutions to expand their loan portfolios and offer borrowers new sources of credit. Consequently, the interstate consumer lending market is becoming ever more competitive.[1] At the same time, the increasing frequency of interstate consumer credit transactions has propelled financial institutions, government regulatory agencies, and their legal counsel into strenuous and often complex debate over the legal requirements applicable to these transactions.[2] The complexity of this debate is not surprising, due to the presence of a variety of state and federal regulatory agencies overseeing financial institutions, as well as the broad range of state laws and the growing number of federal laws applicable to consumer credit transactions.[3] Principles of federalism and choice-of-law accordingly play a prominent role in attempting to resolve the issues that may arise as a result of interstate lending programs.[4]

Interstate lending by federally-insured financial institutions involves one central issue: exportation of interest rates and other credit terms. What legal restrictions should govern an interstate credit transaction? May a financial institution "export" rates and terms to out-of-state borrowers by charging the rates and fees and imposing other contract terms authorized by the laws of the state where it is located? Is the financial institution subject to provisions of the law of the borrower's home state that may be more restrictive? To what extent does federal law preempt state law?

Despite nearly two decades of analysis and debate,[5] only one issue has been conclusively resolved: a national bank may "export" the interest rate permitted by the law of the state where it is located to borrowers residing in other states.[6] Some state regulators continue to assert that national banks and other federally insured financial institutions may not "export" fees and other terms, claiming that the "exporting" lender remains subject to all state law restrictions other than the interest rate.[7] In two recently-filed actions against national banks,[8] the Iowa Attorney General has asserted that several of the non-rate credit terms included in the defendants' credit card agreements[9] violate Iowa law. These are

1. Cocheo, *Bank Cards at the Crossroads*, ABA Banking J., Sept. 1987, at 66, 68-69, 71-72, 75; McCoy and Swartz, *Plastic Battle: Big Credit Card War May Be Breaking Out, to Detriment of Banks*, Wall. St. J., Mar. 19, 1987, at 1, 20.
2. *See, e.g.*, Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions*, 42 Bus. Law. 929 (1987) [hereinafter cited as Burgess]; Rosenblum, *Exporting Annual Fees*, 41 Bus. Law. 1039 (1986) [hereinafter cited as Rosenblum]; Pulles, *Exporting Non-Interest-Rate Provisions*, 39 Bus. Law. 1271 (1984); Culhane and Kaplinsky, *Trends Pertaining to the Usury Laws*, 38 Bus. Law. 1329 (1983) [hereinafter cited as Culhane and Kaplinsky]; Burke and Kaplinsky, *Unraveling the New Federal Usury Law*, 37 Bus. Law 1079 (1982) [hereinafter cited as Burke and Kaplinsky]; Arnold and Rohner, *The "Most Favored Lender" Doctrine for Federally Insured Financial Institutions—What Are its Boundaries?*, 31 Cath. U.L. Rev. 1 (1981) [hereinafter cited as Arnold and Rohner].
3. *See* Burgess, *supra* note 2, at 939-41.
4. *Id.* at 939. *See, e.g.*, *infra* text accompanying notes 48-51, 177-186, 252-260, 270-275, & 305-316.

* The views expressed in this article are those of the authors and do not necessarily represent the views of Household Finance Corporation or its affiliates.

5. *See* Shanks, *Special Usury Problems Applicable to National Banks*, 87 Banking L.J. 483 (1970) [hereinafter cited as Shanks], for an early treatment of some of these issues.
6. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 313-19 (1978).
7. *See generally* Burgess, *supra* note 2. *But see* Letter from Sam Kelley, Texas Consumer Credit Commissioner, to George E. Henderson (Mar. 14, 1985) (unpublished) [hereinafter cited as Kelley opinion].
8. Iowa ex rel. Miller v. Citibank (South Dakota), Civ. No. 88-189-E (S.D. Iowa, filed Apr. 11, 1988); Iowa ex rel. Miller v. First Nat'l Bank, Civ. No. 88-20 (D. Del., filed Jan. 19, 1988, dismissed Apr. 15, 1988). The *First National Bank* suit has been settled, with the bank agreeing to comply prospectively with Iowa law on fees and charges on accounts held by Iowa residents, subject to amendments to federal or Iowa statutes, Comptroller of the Currency (OCC) regulations, Iowa regulations, or supervening case Law. SO BNA's Banking Rep. 711 (1988); at 4; telephone interview with Walter Tuthill, attorney for First National Bank, Wilmington, Del. (Apr. 12, 1988). At least one private suit challenging the exportation of non-rate terms has been filed in the rural South. The suit developed from collection efforts by two banks against the same customer. Newman, *Iowa Nears Settlement in Card Fee Suit*, Am. Banker, Mar. 28, 1988, at 30.
9. The Attorney General challenged First National Bank of Wilmington's, Delaware choice-of-law provision, late charge, returned check charge, overlimit charge, court costs and attorney's fees provision, and notice of change of terms provision. Citibank (South Dakota), N.A.'s South Dakota choice-of-law provision, late charge, returned check charge, definition of "default," attorney's fees and collection costs provision and notice of change of terms provision are being challenged.

among the first cases in which a national bank's (or any other federally-insured institution's) authority to export non-rate terms has been challenged.

State legislatures have adopted conflicting positions concerning these institutions' rate and other term exportation rights. The Connecticut legislature has enacted a law regulating the interest rates that certain types of out-of-state financial institutions having offices or affiliates with offices in the state may charge to Connecticut borrowers,[10] despite the clear[11] or arguable[12] rate exportation rights of various federally-insured financial institutions. Conversely, the South Dakota legislature has declared that virtually all fees and charges are deemed "interest."[13] The Pennsylvania legislature, while continuing to limit sellers and holders of retail installment accounts to an 18% rate ceiling on accounts issued to buyers domiciled in the state, has deregulated rates on such accounts issued to buyers domiciled outside the state.[14]

This article will compare the most favored lender and exportation rights of national banks, federally-insured savings institutions, and federally-insured state banks. In the process, this article will examine recent developments regarding the application of the most favored lender doctrine to these institutions and analyze many of the theories offered in support of the exportation of fees and terms other than the interest rate. This article will not attempt to resolve all of the unanswered questions relating to these institutions' interstate lending operations. Rather, it will describe a matrix of issues and considerations that national banks and other federally-insured financial institutions must analyze thoroughly and weigh carefully as a part of any decision to engage in interstate consumer lending.

I. National Banks

A. Section 85 and the Most Favored Lender Doctrine

1. Interpretation of Section 85

The National Bank Act,[15] at 12 U.S.C. section 85 (section 85),[16] establishes the interest rate that a national bank may charge on extensions of credit. The maximum rate chargeable by a national bank is thus a federal question.[17] Section 85 incorporates state law to determine the maximum rate[18] through application of three clauses.

First, a national bank generally may charge interest at the greater of "the rate *allowed* by the laws of the State . . . where the bank is located," or one percent in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the district where the bank is located.[19] In *Tiffany v. National Bank*,[20] the United States Supreme Court interpreted the "allowance clause" to refer not to the rate allowed for state banks, but to the rate allowed for "lenders generally,"[21] even if such rate exceeds the rate permitted to state banks under state law.[22] *Tiffany* did not determine whether the term "laws" referred to in the "allowance clause" encompasses a state regulated lender statute which characteristically constitutes an exception to a general state usury law and authorizes such lenders to charge higher rates than those permitted to "lenders generally" under state law.[23] It was left for the Comptroller of the Currency (OCC) to issue an interpretation of section 85 (the OCC Ruling) providing that a national bank may charge the highest rate authorized under state law for any competing state-chartered or licensed lender, without becoming licensed under such state law.[24] The OCC Ruling codifies what has come to be known as the "most favored lender" doctrine. The alternative rate of one percent over the discount rate contained in the first clause of section 85, added in 1933,[25] represents a federal rate which preempts lower rates provided for

10. An Act Concerning the Activities of Foreign Banking Corporations, 1987 Conn. Pub. Acts No. 87-205, § 5 (effective July 1, 1987). To the extent that this law attempts to regulate the Connecticut activities of out-of-state financial institutions in a way that would infringe on those institutions' rights granted under federal law, it would appear to violate the supremacy clause and the commerce clause. *See* Lewis v. BT Inv. Managers, Inc., 447 U.S. 27 (1980); U.S. Const. art. 1, § 8, cl. 3; art. VI, cl. 2. *But see* Sears, Roebuck & Co. v. Brown, 806 F.2d 399 (2d Cir. 1986) (Connecticut statute regulating holding companies and their subsidiaries held not to violate commerce clause or supremacy clause).

11. *See Marquette*, 439 U.S. at 313-19 (national banks).

12. *See* Letter from General Counsel to the Federal Home Loan Bank Board (Aug. 6, 1982), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) para. 82,022 (federally-insured savings institutions); Letter from Kathy A. Johnson, Attorney to the Federal Deposit Insurance Corporation (FDIC) (Mar. 17, 1981) (unpublished) (federally-insured state banks) [hereinafter cited as Johnson letter]; Letter from Peter M. Kravitz, Senior Attorney to the FDIC (Oct. 20, 1983) (unpublished) (federally-insured state banks) [hereinafter cited as Kravitz letter].

13. An Act to Revise Certain Statutes Pertaining to Interest and Charges Between Debtors and Creditors, 1987 S.D. Sess. Laws ch. 360. Similar legislation is pending in Delaware. O'Connor, *Interstate Credit Cards and Other Products*, in Fischer, Retail Financial Services: Current Developments 182, 271-76 (1987) (outline prepared for distribution at June 11-12, 1987, Practising L. Inst. program, New York, N.Y.). The Delaware legislation also would declare virtually all fees, charges, and other statutory provisions to be "material to the determination of the interest rate." *See* 12 C.F.R. § 7.7310(a) (1987).

14. 1988 Pa. Laws. Act 15 (effective Feb. 26, 1988). The distinction between rates chargeable to in-state and out-of-state borrowers raises constitutional questions under the commerce clause, equal protection clause, and privileges and immunities clause. U.S. Const. art. 1, § 8, cl. 3; art. 4, § 2, cl. 1; amend. XIV, § 1.

15. 12 U.S.C. §§ 21-200 (1982 & Supp. V 1987).

16. *Id.* § 85 (1982). Section 85 provides in pertinent part:
> Any association 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 this chapter. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 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 such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run.
> *Id.*

17. *Marquette*, 439 U.S. at 308 (citing Farmers' & Mechanics' Nat'l Bank v. Dearing, 91 U.S. 29, 34 (1875)).

18. Evans v. Nat'l Bank, 251 U.S. 108, 111 (1919). *But cf.* City Nat'l Bank v. Edmisten, 681 F.2d 942 (4th Cir. 1982) (no federal question jurisdiction under section 85 when declaratory judgment sought that annual fee would not violate state usury law if added to interest charged). *See infra* text accompanying notes 48-51, 177-186, & 252-262 for a discussion of the extent to which state law is incorporated in section 85.

19. 12 U.S.C. § 85 (1982) (emphasis added).

20. 85 U.S. (18 Wall.) 409 (1874).

21. *Id.* at 411. The Court also used the term "natural persons" to refer to "lenders generally" because individuals frequently operated as private bankers during that time. *See* Comment, *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View*, 27 Vill. L. Rev. 1077, 1083 n.34 and authority cited therein (1982) [hereinafter cited as *A Contrary View*].

22. 85 U.S. (18 Wall.) at 411.

23. Such a statute was not at issue. *Id.* at 411. *See A Contrary View*, *supra* note 21, at 1095-96; Burke and Kaplinsky, *supra* note 2, at 1096.

24. 12 C.F.R. § 7.7310(a) (1987). The OCC Ruling provides:
> A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company or morris plan bank, without being so licensed.
> *Id.* The OCC Ruling was initially issued as an opinion letter in 1936 and was finally promulgated as an interpretive ruling in 1971 and codified in 1972. For the history and development of the OCC Ruling, *see A Contrary View*, *supra* note 21, at 1089-91 & nn.82-89; Burke and Kaplinsky, *supra* note 2, at 1100-01 n.121; Arnold and Rohner, *supra* note 2, at 6-7. For a discussion of the OCC Ruling's validity, scope, and interpretation, *see infra* text accompanying notes 56-226.

25. Act of June 16, 1933, ch. 89, § 25, 48 Stat. 191 (1933) (amending National Bank Act, ch. 106, § 30, 13 Stat. 108 (1864)) (current version at 12 U.S.C. § 85 (1982)). *See A Contrary View*, *supra* note 21, at 1078 n.7, 1081 n.24 for a history of the amendments to section 85.

under state law.[26]

The second clause is an exception to the first which provides that "[w]here by the laws of *any* State a *different* rate is *limited* for [state banks], the rate so limited shall be *allowed* for [national banks] organized or *existing* in any such State."[27] The *Tiffany* Court held that the "exception clause" applies only where the rate permitted to state banks is higher than that allowed for lenders in general.[28] The combination of the "any State" and "existing" phraseology in the "exception clause" has led national banks to contend that they may "import" the rate allowed by a borrower's home state's laws if it is higher than the rate in the bank's home state.[29]

Finally, section 85 states that where no rate is fixed by state law, national banks may charge the greater of seven percent or one percent over the discount rate.[30] In *Daggs v. Phoenix National Bank*,[31] the United States Supreme Court held that this clause does not apply if state law allows creditors to contract for any rate under a written agreement.[32] Similarly, the Ninth Circuit held in *Hiatt v. San Francisco National Bank*[33] that a national bank was authorized to charge any rate even though California law exempted state and national banks from its usury restrictions, which could have meant that no rate was fixed by state law.[34] Consequently, the third clause of section 85 is essentially meaningless.[35]

The interpretation of five other terms or phrases in section 85 is important in determining the most favored lender and exportation rights of national banks. A national bank is authorized to "take, receive, *reserve*, and charge [interest] on any *loan* or *discount* made."[36] In *Evans v. National Bank*,[37] the United States Supreme Court noted that national banks are authorized to discount promissory notes[38] and determined that discounting implies reservation of interest in advance.[39] The National Bank Act thus may permit the charging of discount interest at the maximum state rate, even though the maximum state rate is established in terms of a simple interest rate and discounting is specifically prohibited.[40]

Moreover, the rate chargeable under section 85 may be imposed on "*any* loan[,] discount . . . , notes, bills of exchange or *other evidences of debt*."[41] In construing the term "specified class of loans"[42] contained in the OCC Ruling, the court in *United Missouri Bank v. Danforth*[43] determined that retail credit sales and loans constitute an interchangeable class of debt.[44] The court based its conclusion on the "other evidences of debt" language in section 85.[45] To the extent adopted by the courts, a broad classification of transactions will enhance a national bank's flexibility in establishing the terms under which it will operate a particular type of loan program.

Third, section 85 empowers national banks to charge *"interest"* at the highest rate allowed under the laws of the state where it is located.[46] The largely unresolved issues regarding the definition of "interest" and whether the definition should be obtained from federal law, the law of the bank's home state, or the law of the borrower's home state, are critical in delineating national banks' rights to export fees and other contract terms in addition to the interest rate.

Fourth, "interest" may be imposed at the "*rate* allowed by the *laws*" of the bank's home state.[47] There have been differing views as to whether the state law incorporated in section 85 encompasses only the numerical rate,[48] the method of calculating the rate as well,[49] or even the entire case law interpreting limitations on usury,[50] including common law conflict of laws rules.[51]

Finally, a national bank obtains its maximum rate by reference to "the laws of the State where the bank is *located*."[52] In *Marquette National Bank v. First of Omaha Service Corp.*,[53] the Supreme Court held that a national bank is located in the state named in its organization certificate.[54] This decision underlies the establishment in *Marquette* of national banks' authority to "export" interest rates in interstate lending programs.[55]

26. *Marquette*, 439 U.S. at 318 n.31; OCC Interpretive Letter No. 71 from John G. Heimann, Comptroller of the Currency (Dec. 1, 1978), *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,146.

27. 12 U.S.C. § 85 (1982) (emphasis added).

28. *Tiffany*, 85 U.S. (18 Wall.) at 411-12. The Court noted that section 85 "speaks of allowances to National banks and limitations upon State banks, but it does not declare that the rate limited to State banks shall be the maximum rate allowed to National banks." *Id.* at 412. The Court effectively substituted "higher" for "different" in the "exception clause" based on the absence of the "and no more" language found in the "allowance clause." *Id. See A Contrary View*, *supra* note 21, at 1083 & nn. 36-37 and authorities cited therein. The Court emphasized the need to protect national banks against unfriendly state legislation. 85 U.S. (18 Wall.) at 412-13.

29. *See infra* text accompanying notes 236-246 for a discussion of national banks' rights to "import" rates.

30. 12 U.S.C. § 85(1982). The one percent over the discount rate option was added in 1933. Act of June 16, 1933, ch. 89, § 25, 48 Stat. 191 (1933) (amending National Bank Act, ch. 106, § 30, 13 Stat. 108 (1864)) (current version at 12 U.S.C. § 85 (1982)).

31. 177 U.S. 549 (1900).

32. The Court construed the phrase "no rate is fixed" to refer only to circumstances where no rate is "allowed" by state law, i.e., where state law prohibits the charging of any interest. *Id.* at 555.

33. 361 F.2d 504 (9th Cir.), *cert. denied*, 385 U.S. 948 (1966), *rehearing denied*, 385 U.S. 1021 (1967).

34. Under state law there was thus no limit on the rate a state bank could charge. The court interpreted this usury exemption to mean that rates were "fixed" as without limitation except as agreed to by the parties, and concluded that national banks should be accorded the same treatment. 361 F.2d at 507. *See* Cal. Const. art. XV, § 1 (West Cum. Supp. 1987).

35. *See* OCC Interpretive Letter No. 138 from John E. Shockey, Chief Counsel (Feb. 8, 1980), *reprinted in* [1980-1981 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,219, at 77,328 (citing Shanks, *supra* note 5, at 488 (suggesting that "for all practical purposes, the 7 percent ... limit ... may be ignored.")).

36. 12 U.S.C. § 85 (1982) (emphasis added).

37. 251 U.S. 108.

38. *See* 12 U.S.C. § 24 (Seventh) (Supp. V 1987) (national banks have the power to discount promissory notes, drafts, bills of exchange, and other evidences of debt).

39. 251 U.S. at 114. The case involved the discounting of short-term single payment commercial paper. *See infra* note 40.

40. *See infra* text accompanying notes 100-104 & 187-200 for a discussion of whether or not national banks may charge discount interest on installment credit.

41. 12 U.S.C. § 85 (1982) (emphasis added).

42. 12 C.F.R. § 7.7310(a) (1987). *See supra* note 24 for text of the OCC Ruling. *See also Infra* text accompanying notes 76-81 & 130-155 for a discussion of this term.

43. 394 F. Supp. 774 (W.D. Mo. 1975).

44. *Id.* at 783. The court held that the bank could charge the Small Loan Act rate on credit sale transactions governed by the Retail Credit Sales Act (RCSA), even though the RCSA exempted licensed small loan companies from its provisions. *Id.* at 784.

45. *Id. See infra* text accompanying notes 130-155 for a discussion of the classification of transactions.

46. 12 U.S.C. § 85 (1982) (emphasis added).

47. *Id.*

48. *Evans*, 251 U.S. at 111. *See* Nat'l Bank v. Johnson, 104 U.S. 271, 277-78 (1881); *Dearing*, 91 U.S. at 34.

49. This includes all prohibitions on enlarging the rate, even if the resulting charge is within the legal limit if imposed properly. Citizens' Nat'l Bank v. Donnell, 195 U.S. 369, 374 (1904); Att'y Gen. v. Equitable Trust Co., 294 Md. 385, 417, 450 A.2d 1273, 1291-92 (1982).

50. First Nat'l Bank v. Nowlin, 590 F.2d 872, 876 (8th Cir. 1975). *See* Union Nat'l Bank v. Louisville, N.A. & C. Ry., 163 U.S. 325, 331 (1896).

51. OCC Interpretive Letter No. 325 from Peter Liebesman, Assistant Director of the Legal Advisory Services Division (Jan. 22, 1985), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,495, at 77,754. *See* Shanks, *supra* note 5, at 489-91. *But see* Morosani v. First Nat'l Bank, 539 F. Supp. 1171, 1173 (N.D. Ga. 1982), *rev'd on other grounds*, 703 F.2d 1220 (11th Cir. 1983).

52. 12 U.S.C. § 85 (1982) (emphasis added).

53. 439 U.S. 299.

54. *Id.* at 310. The Court engaged in a federal common law choice-of-law analysis concerning Omaha Bank's Bank-Americard program to confirm that Omaha Bank was "located" in Nebraska. *Id.* at 309-13. *See Infra* text accompanying notes 229-235 for further discussion of the "location" question relating to national banks.

55. *Id.* at 313-19.

Unfortunately, for national banks this analysis of section 85 resolves neither the scope of the most favored lender doctrine nor many of the issues which arise in the context of interstate lending operations. A national bank also must explore the validity, scope, and interpretation of the OCC Ruling, which necessarily involves further examination of section 85, in order to determine the bank's authority to export the highest interest rate, or the most advantageous fees and other contract terms, allowed in its home state to borrowers residing in other states.

2. The OCC Ruling

a. Validity and Scope

A federal appellate court first upheld the OCC Ruling[56] in 1972 in *Northway Lanes v. Hackley Union National Bank & Trust Co.*[57] Its validity has since been confirmed and its criteria applied implicitly or explicitly by the Courts of Appeals for the Fifth,[58] Seventh,[59] and Eighth[60] Circuits, as well as several other courts.[61] Only two state trial courts have declined to adopt the OCC Ruling.[62] The Supreme Court cited the OCC Ruling with apparent approval in *Marquette,* at least to the extent of the Ruling's incorporation of the most favored lender doctrine,[63] but declined to address its validity. The Court still has not decided this issue, and, based on the scope of the OCC Ruling detailed below, it is unclear whether the Court would uphold it as a reasonable interpretation of section 85.[64]

Perhaps the most useful basis for examining the validity of the OCC Ruling as an interpretation of section 85 is to determine whether the Ruling is broader or more restrictive than section 85. This determination will be based on an analysis of the following key concepts and terms contained in the OCC Ruling.[65]

(1) The Need for a "Borrowing"

The OCC Ruling clearly is applicable when a national bank is borrowing the rate authority set forth in section 85 from a state-supervised lender. It is therefore important to determine when a national bank is borrowing its rate. A national bank always may contend that it is borrowing its rate, unless the highest rate is applicable only to national banks under a particular state's laws.[66] National banks may even borrow a usury exemption available to a state-chartered lender. In *Hiatt v. San Francisco National Bank,*[67] national banks held the same exemption from state usury laws as state banks. The Ninth Circuit applied the allowance and exception clauses of section 85 to allow a national bank to borrow the state bank's rate exemption rather than rule that no rate was "fixed" by state law.[68]

State rate structures generally are established in one of four different ways: (1) by class of loans (i.e., consumer versus commercial, closed-end versus open-end, direct lending versus sales finance, real estate mortgages versus automobile loans versus bank credit cards, etc.); (2) by class of lenders (i.e., banks versus savings and loans versus licensed lenders); (3) in a nondiscriminatory manner (i.e., under an undifferentiated Uniform Consumer Credit Code or usury law); or (4) in some combination of the first three alternatives. Based on *Hiatt,* national banks may borrow a rate established under any of these four schemes.

Several commentators have argued that to the extent that national banks have independent authority under state law to charge the highest state rate, and another class of lender has the same authority, national banks are not borrowing their authority from that class lender. In that case, the commentators assert that the OCC Ruling does not apply.[69] Under this interpretation, the OCC Ruling is merely a borrowing regulation.[70] In order to obtain its benefits, a national bank cannot already be the most favored lender in the state. This reading of the OCC Ruling is too rigid and ignores the language of section 85. Section 85 does not require borrowing; rather, it authorizes a national bank to borrow rates in order to become a most favored lender. As *Tiffany* and the OCC Ruling have indicated, section 85 recognizes three classes of lenders: "lenders generally," state banks, and other state-chartered or licensed lenders.[71] National banks may either have parity with one or more classes under state law or be accorded parity pursuant to section 85. Thus, the better view under *Tiffany* and *Hiatt*, as partially codified[72] in the OCC Ruling, is that a national bank is always deemed to be borrowing its rate from the "highest rate" lender in the state, even if the national bank also is a most favored lender.

(2) "Competing Lender"

Section 85 on its face does not contain a "competing lender" test. The *Tiffany* Court did not require national banks to compete with the highest rate lender in order to charge such a rate.[73] Subsequent decisions by courts and state regulators, with few exceptions, and an OCC staff letter have ruled that the OCC Ruling does not require actual competition.[74] Even if this test merely requires that the most favored lender may engage in the same type of credit transaction as a national bank,[75] it expands the plain language of section 85. By incorporating

56. *See supra* note 24 for text of the OCC Ruling.

57. 464 F.2d 855, 864 (6th Cir. 1972). The court determined that it should defer to a reasonable interpretation of the National Bank Act promulgated by the OCC, the agency charged with the Act's administration. *Id.* (citing Udall v. Tallman, 380 U.S. 1, 17 (1965); FHA v. Darlington, Inc., 358 U.S. 84, 90 (1958); Unemployment Compensation Comm'n v. Aragan, 329 U.S. 143, 153-54 (1946)).

58. Partain v. First Nat'l Bank, 467 F.2d 167, 174 (5th Cir. 1972).

59. Fisher v. First Nat'l Bank (Fisher/Chicago), 538 F.2d 1284, 1290 (7th Cir. 1976), *cert. denied*, 429 U.S. 1062 (1977).

60. Fisher v. First Nat'l Bank (Fisher/Omaha), 548 F.2d 255, 259-60 (8th Cir. 1977). *See Nowlin*, 590 F.2d 872 (never referred to OCC Ruling, although used term "most favored lender").

61. *See, e.g.*, Ray v. American Nat'l Bank & Trust Co., 443 F. Supp. 883 (E.D. Tenn. 1978); *Danforth*, 394 F. Supp. 774; *Equitable Trust*, 294 Md. 385, 450 A.2d 1273; Comm'r of Small Loans v. First Nat'l Bank, 268 Md. 305, 300 A.2d 685 (1973); First Bank v. Miller, 131 Mich. App. 764, 347 N.W.2d 715 (Mich. App. 1984) (case involved state banks, but OCC Ruling invoked for comparative purposes).

62. Deak Nat'l Bank v. Bond, 89 Misc. 2d 95, 390 N.Y.S.2d 771 (Sup. Ct. 1976); Colo. Nat'l Bank v. Coder, [1969-1973 Transfer Binder] Cons. Cred. Guide (CCH) para. 99,018 (Mont. Dist. Dec. 29, 1972) (still applied "competing lender" test).

63. 439 U.S. at 314 n.26.

64. *See supra* note 57 and authorities cited therein. *See also infra* text accompanying notes 112-115.

65. The other important question regarding the scope of the OCC Ruling is whether it should apply to interstate loans or only to intrastate loans. *See infra* text accompanying notes 296-300 for an analysis of this issue.

66. An analysis of the statutory schemes of all 50 states is beyond the scope of this article. It seems unlikely, however, that any such state statutory scheme exists.

67. 361 F.2d 504.

68. *Id.* at 507.

69. *See* Burgess, *supra* note 2, at 938-39; *A Contrary View*, *supra* note 21, at 1093.

70. Burgess, *supra* note 2, at 938.

71. 85 U.S. (18 Wall.) at 411-12; 12 C.F.R. § 7.7310(a) (1987).

72. *See infra* text accompanying notes 82-83.

73. 85 U.S. (18 Wall.) at 411-412.

74. *See infra* text accompanying notes 116-124 and authorities cited therein for a more thorough analysis of the "competing lender" standard.

75. *Danforth*, 394 F. Supp. 774, 784.

this test, the OCC Ruling is therefore more restrictive than section 85.

(3) "Specified Class of Loans"

Section 85 also does not provide for a "specified class of loans" test. As interpreted in *Tiffany*, section 85 does not recognize distinctions among classes of loans, but only among classes of lenders: "lenders generally" and state banks.[76] In the course of interpreting the OCC Ruling, a state supreme court[77] and the OCC staff[78] have applied the "class of loans" standard rigorously to restrict national banks' use of the most favored lender doctrine.[79] Conversely, interpreting the OCC Ruling in light of the "other evidences of debt" language in section 85, a federal district court essentially has expunged the test from the Ruling.[80] The latter approach seems more faithful to both the wording and the intent of section 85.[81] Again, in this instance, the OCC Ruling is more restrictive than section 85.

(4) "Class of Lender"

Section 85 and the OCC Ruling both incorporate a "class of lender" standard. Under *Tiffany*, national banks may obtain rate parity with natural persons or state banks.[82] The OCC Ruling is more restrictive than section 85 to the extent that natural persons are not required to be chartered or licensed by a state in order to extend credit. Otherwise, section 85 and the OCC Ruling essentially provide for an identical standard.

Section 85 has established one percent over the discount rate as a federal alternative rate, but has not directly incorporated other federal usury laws.[83] Advantageous rates which may be charged by other federally-chartered lenders are therefore available to national banks only if directly incorporated by state law.[84] The OCC Ruling reaches the same conclusion.[85]

A national bank may contend that the state law relied on under section 85 indirectly incorporates federal usury laws pursuant to the supremacy clause.[86] A court probably would reject this argument, however, due to the references to state law and the insertion of a specific federal alternative rate in section 85. The OCC staff already has rejected this argument.[87]

(5) State Licensing Exemption

The federal banking laws and an OCC regulation exempt national banks from state licensing requirements.[88] Thus, under section 85, a national bank is permitted to charge the highest rates available to any state-licensed lender without being licensed by that state. The OCC Ruling so provides,[89] and the statute and the Ruling consequently contain an equally broad licensing exemption.

(6) "Material to the Determination of the Interest Rate"

The inquiry under section 85 as to what constitutes "interest" and the query under the OCC Ruling as to which provisions of a law governing a class of loans are "material to the determination of the interest rate" are quite distinct. The answer to the former determines which fees and other terms are charges for the use or forbearance of money,[90] while the response to the latter specifies which fee and other provisions of the governing law a national bank must comply with in order to borrow the most favored lender's rate. Moreover, the responses to these questions depend on which law (federal or state, and, if state law, the law of the bank's home state or the borrower's home state) and what type of construction of the OCC Ruling (strict or broad) is applied. Finally, a particular bank's views concerning the applicable law and the degree to which it should apply may depend on whether the fees and terms allowed under such law are considered attractive or burdensome to the bank.[91]

The "materiality" test applies in fewer situations than the test as to what constitutes "interest" under section 85. Under the OCC Ruling, it only applies when "state law permits a higher rate on a specified class of loans [and] a national bank [is] making such loans at such higher rate."[92] Section 85, on the other hand, includes no class of loans test.[93] Nevertheless, when the "materiality" test is applicable, and the expansive interpretation of the test established in *Attorney General v. Equitable Trust Co.* is followed, the OCC Ruling requires a national bank to comply with considerably more provisions of its home state's law than section 85. Under *Equitable Trust*, provisions are "material" if they are "material to judicial determination of whether or not the interest charged in a given transaction is unlawful."[94] In applying this test, the court ruled that every provision of the Maryland Consumer Loan Law (MCLL)[95] was material except one that subjected the lender to the borrower's claims and defenses against a seller of goods.[96] No federal or state definition of "interest" is this expansive.[97]

76. 85 U.S. (18 Wall.) at 411-12. The absence of classes of loans under Missouri law in the early 1870s may explain why the Court did not draw such distinctions. *Id.* at 411. *See Equitable Trust*, 294 Md. at 397, 450 A.2d at 1281 and authorities cited therein, for a brief history of the development of installment and open-end credit in the U.S.

77. *Equitable Trust*, 294 Md. 385, 450 A.2d 1273.

78. OCC Interpretive Letter No. 178 from Richard V. Fitzgerald, Director of the Legal Advisory Services Division (Jan. 12, 1981), *reprinted in* [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,259.

79. Credit card cash advances and purchases were determined to be different classes of loans. *Equitable Trust*, 294 Md. at 413-14, 450 A.2d at 1290; OCC Interpretive Letter No. 178, *supra* note 78.

80. *Danforth*, 394 F. Supp. at 784-85.

81. *See* 12 U.S.C. § 85 (1982). *But see Northway Lanes*, 464 F.2d at 862 (citing Cong. Globe, 38th Cong., 1st Sess. 2123-26 (1864) (remarks of Sen. Grimes)).

82. *See supra* text accompanying note 76.

83. *See* 12 U.S.C. § 85 (1982).

84. *See infra* text accompanying notes 127-128.

85. 12 C.F.R. § 7.7310(a) (1987).

86. *See* U.S. Const. art. VI, cl. 2.

87. OCC Interpretive Letter No. 255 from Peter Liebesman, Assistant Director of the Legal Advisory Services Division (Jan. 19, 1983), *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,419. *Contra*, Culhane and Kaplinsky, *supra* note 2, at 1336-39.

88. 12 U.S.C. §§ 24 (Seventh), 484 (Supp. V 1987); 12 C.F.R. § 7.6025(b) (1987). *See also infra* text accompanying notes 221-226.

89. *See* 12 C.F.R. § 7.7310(a) (1987).

90. *See* Rosenblum, *supra* note 2, at 1044 n.24; Burke and Kaplinsky, *supra* note 2, at 1106.

91. *See, e.g.*, Rosenblum, *supra* note 2, at 1042-43 n.20.

92. 12 C.F.R. § 7.7310(a) (1987). *See infra* text accompanying notes 130-152. The "materiality" test also has been applied in several Minnesota state court cases involving state banks. *See infra* text accompanying notes 427-430.

93. *See supra* text accompanying notes 76-80. *See also infra* text accompanying notes 148-150.

94. 294 Md. at 418, 450 A.2d at 1292.

95. The MCLL, a closed-end loan statute, was being applied to open-end cash advances. *Id.* at 417, 450 A.2d at 1292.

96. *Id.* at 418-24, 450 A.2d at 1292-95. *See infra* text accompanying notes 159, 161, 175, & 208-217 for a listing of material provisions.

97. The recently-enacted South Dakota revolving loan law amendments, which permit banks located in that state to impose virtually any type of charge and deem all such charges to be "interest," may most closely approach the scope of *Equitable Trust*. An Act to Revise Certain Statutes Pertaining to Interest and Charges Between Debtors and Creditors, 1987 S.D. Sess. Laws ch. 360. An OCC staff letter provides that "all charges permitted or prohibited by state law in connection with particular types of loans may be defined as 'interest.'" "OCC Interpretive Letter from Richard V. Fitzgerald, Director of the Legal Advisory Services Division (Nov. 24, 1980) (unpublished) (construing *Northway Lanes*, 464 F.2d 855) [hereinafter cited as Fitzgerald letter].

The scope of state law coverage under the OCC Ruling and section 85 is more comparable under the three-part test of "materiality" enunciated in an OCC interpretive letter issued by Peter C. Liebesman, then Assistant Director of the Legal Advisory Services Division, four months after the *Equitable Trust* decision (the Liebesman letter).[98] The Liebesman letter states that (1) state law provisions which establish "the characteristics—such as size, maturity and classes of borrowers—of a category of loans are . . . material"; (2) state laws which "establish the manner in which the numerical rate of interest is determined" (i.e., prohibitions against compounding interest) also are "material"; and (3) "because of conflicting judicial opinions, it is less clear whether [section 85] incorporates state laws which do not determine the allowed numerical rate . . . but affect the ultimate return on loan proceeds."[99]

These conflicting opinions reflect concern whether state law prohibitions on discounting interest apply to national banks, when discounting "would provide an effective yield greater than [the] interest permitted."[100] The Liebesman letter cites *Evans*[101] and *Northway Lanes*,[102] apparently to the effect that section 85 preempts conflicting state law, and *First National Bank v. Nowlin*,[103] apparently for the proposition that *Evans* should be limited to cases involving single payment short-term paper.[104] Among the other state law provisions that seemingly would be covered by the third category in the Liebesman letter are additional charge authorizations, free-ride periods, balance calculation methods (except for prohibitions on compounding), change of terms and other notice requirements, and restrictions on acceleration and account cancellation.[105] Thus, the Liebesman test incorporates a greater variety of state law provisions than virtually any federal or state definition of "interest."[106]

Even under the *Equitable Trust* "materiality" standard, some provisions of a national bank's home state's laws, such as disclosure requirements,[107] will not apply to the bank. A recent article suggests that the limited applicability of state law to a national bank under this standard "is arguably in conflict with" Supreme Court precedent that "national banks are subject to state law except to the extent that such law conflicts with or frustrates the purpose of federal legislation or disrupts the banks in the performance of their duties as federal instrumentalities."[108] Close analysis reveals that this "federal instrumentality" doctrine represents a principle of both federal preemption *and* broad applicability of state law in the *absence* of either federal preemption or impairment of national banks' efficiency as federal agencies.[109] In an intrastate loan,[110] general applicability of state law under the federal instrumentality doctrine must yield to the specific federal preemption contained in the OCC Ruling. Because the OCC Ruling incorporates state law only to a limited extent, however, the doctrine seemingly requires national banks to comply with *other* applicable home state laws which (1) are not preempted by other federal laws, or (2) do not contravene the doctrine itself, i.e., disrupt national banks in the performance of their duties. There is thus no conflict; the federal instrumentality doctrine operates independently of and in addition to the OCC Ruling.[111]

(7) Would the Supreme Court Uphold the OCC Ruling?

The OCC Ruling, although an apparently well-intentioned effort to interpret section 85, nevertheless represents a more restrictive statement of the most favored lender doctrine than the statute in almost every respect. The Ruling parallels section 85 only in its state licensing exemption, and is broader than the statute only as to the range of state law provisions with which a national bank must comply. Moreover, the Ruling requires compliance with a broader range of state laws than section 85 only if a national bank is extending credit at the most favored lender rates on a specified class of loans.[112] Moreover, in an intrastate loan, the operation of the federal instrumentality doctrine equalizes the scope of state law applicable to national banks under section 85 and the OCC Ruling.

Thus, given the generally restrictive interpretation that the OCC Ruling accords section 85, it seems that the Ruling should not be entitled to great deference by the courts.[113] The Supreme Court, if it were to interpret the language of the Ruling literally, could well find it incompatible with the broad policy of the National Bank Act to encourage the development of a modern interstate banking system.[114] Conversely, the Court might simply disregard the portions of the OCC Ruling which it deems objectionable and apply the remainder of the Ruling, as lower courts have done.[115]

National banks therefore may not be able to rely on the OCC Ruling to determine which provisions of their home states' laws they must comply with in order to borrow the most favored lender's rate. In situations where the borrowed law contains burdensome provisions, however, national banks may

98. OCC Interpretive Letter from Peter C. Liebesman, Assistant Director of the Legal Advisory Services Division, to Jean M.E. Mille, Staff Counsel to the South Carolina Department of Consumer Affairs (Feb. 4, 1983) (unpublished) [hereinafter cited as Liebesman letter].

99. *Id.* at 3.

100. *Id.* at 3-4.

101. 251 U.S. 108.

102. 464 F.2d 855.

103. 590 F.2d 872.

104. *Id.* at 876. *See infra* text accompanying notes 197-200.

105. *See infra* text accompanying notes 178-179 & 201-220 for a more detailed listing of provisions falling into the third category.

106. *See infra* text accompanying notes 159-220. *But see supra* note 97.

107. *See infra* text accompanying notes 218-220.

108. Rosenblum, *supra* note 2, at 1044 n.26 (citing Anderson Nat'l Bank v. Luckett, 321 U.S. 233 (1944); Davis v. Elmira Savings Bank, 161 U.S. 275 (1896)). *See A Contrary View*, *supra* note 21, at 1113 & nn. 217-218, for a discussion as to whether the federal instrumentality doctrine has become an anachronism since the enactment of the "federal usury" provisions of Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), Pub. L. 96-221, Title V, Part C, §§ 521-529, 94 Stat. 164 (Mar. 31, 1980).

109. First Nat'l Bank v. Missouri, 263 U.S. 640, 656 (1924); *Davis*, 161 U.S. at 283.

110. *See infra* text accompanying notes 303-304 for a discussion of the interplay between the federal instrumentality doctrine and the OCC Ruling in an interstate loan.

111. This analysis is invalid only if subjecting national banks to other applicable state laws would frustrate the purpose of the OCC Ruling and section 85. Section 85 at most requires national banks to comply with their home states' usury laws; it does not appear to prohibit the application of other state laws to a national bank. *See* OCC Interpretive Letter No. 333 from Charles F. Byrd, Assistant Director of the Legal Advisory Services Division (Mar. 20, 1985), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,503.

The interplay between the federal instrumentality doctrine and section 85 would operate in the same manner. The scope of state law made applicable to a national bank due to the doctrine's operation, however, probably would be greater than in the case of the OCC Ruling. *See supra* text accompanying notes 97 & 106.

112. *See supra* text accompanying notes 92-93.

113. *See supra* note 57 and authorities cited therein. *See also A Contrary View*, *supra* note 21, at 1114 n.223 and authorities cited therein.

114. *See Marquette*, 439 U.S. at 312, 318-19.

115. *See, e.g., Danforth*, 394 F. Supp. at 783-85 ("class of loans" and "competing lender" tests).

not want to rely on the Ruling. They may prefer to operate within the generally less inclusive scope of section 85. Nevertheless, when the borrowed law includes beneficial fee and other provisions, national banks may seek to embrace the expansive *Equitable Trust* "materiality" standard. Consequently, it is important to examine thoroughly the interpretation that the courts, the OCC, and state regulators have assigned to the key terms which comprise the OCC Ruling.

b. Interpretation

(1) "Competing Lender"

The predominant view of the courts and regulators is that it is irrelevant whether state-supervised lenders actually engage in the same class of credit transaction as "borrowing" national banks.[116] For example, the court in *United Missouri Bank v. Danforth*[117] declared that "[t]he important determination is whether competing state licensed or chartered lenders *may* engage in the particular type or class of loan, and the rate of interest they *may* charge in connection therewith."[118] Similarly, in authorizing national and state banks to borrow rates applicable to state credit unions, the Michigan Court of Appeals concluded: "[w]e do not consider only the actual membership of credit unions, but also their potential membership. The *potential* for competition in the areas of business and personal loans is sufficiently great that state credit unions must generally be considered as competing lenders of national banks as a matter of federal law."[119] In rejecting an actual competition standard, the OCC staff has noted that imposing such a standard "would result in an unnecessary and complicated evaluation of the geographic banking market in which the national bank is located and a determination of which classes of lenders are offering which types of loans in that market."[120]

In *Fisher/Omaha,*[121] the Eighth Circuit did not even require potential competition. The Court permitted a national bank to borrow Nebraska Small Loan Act rates for credit card purchase and cash advance transactions despite the absence of authorization in the Act for licensees to offer revolving credit.[122] Only one state trial court[123] and one state attorney general[124] have required actual competition in order for a national bank to borrow rates applicable to state-supervised lenders. Nevertheless, the OCC staff's rationale seemingly validates the majority view that a national bank need not compete with a state-supervised lender in order to charge rates permitted to that lender.

(2) "Class of Lender"

The general rule is that a national bank may borrow the interest rate allowed to state-supervised lenders,[125] but not the rate established for other federally-chartered lenders.[126] Where state law permits a state-supervised lender to charge the rates permitted to a federally-chartered lender, however, the OCC staff has opined that a national bank may do likewise.[127] Several states have enacted so-called "rate parity" laws which purport to authorize certain state-chartered lenders to charge rates permitted to any other regulated lenders.[128] Under the OCC Ruling and section 85, national banks therefore should be entitled to apply these parity provisions in order to charge rates permitted to federally-chartered lenders when the state-chartered lenders from which they are borrowing their rates may do so.[129]

(3) "Specified Class of Loans"

The central issue in interpreting the OCC Ruling is whether the term "specified class of loans" should be construed to authorize broad or narrow classification of transactions. Obviously, the broader the classification, the greater the number of laws a national bank is likely to be able to choose among in borrowing its rate (and other "material" terms). *Danforth*[130] is the leading case espousing a broad classification of loans. The Missouri Retail Credit Sales Act (RCSA) exempts a licensed Small Loan Act (SLA) lender from the definition of "retail seller."[131] The *Danforth* court interpreted this exemption to mean that SLA licensees could engage in credit sale transactions covered by the RCSA while charging higher SLA rates.[132] The court ruled that national banks could impose SLA rates on credit card advance and purchase transactions.[133] In reaching its conclusion, the court determined that retail credit sales and loans represent the same class of loan.[134] *Danforth* suggests that all types of consumer credit are fungible under section 85.[135] In *Fisher/Omaha,*[136] the Eighth Circuit also permitted a national bank to borrow the closed-end installment loan rate on open-end credit card purchase and cash advance transactions.[137]

In the most comprehensive analysis of the meaning and scope of the OCC Ruling, the Maryland Court of Appeals[138] narrowly construed "class of loans" in *Attorney General v. Equitable Trust Co.*[139] As in *Danforth* and *Fisher/Omaha,* the plaintiff national banks[140] attempted to apply favorable small loan law rates to credit card purchase and advance transactions. In contrast to the statutory scheme in *Danforth,* however, the Maryland Consumer Loan Law, from which the banks sought to borrow rates, governs only loans. Credit card

116. *Fisher/Omaha*, 548 F.2d at 260; *Danforth*, 394 F. Supp. at 784; *Miller*, 131 Mich. App. at 773, 347 N.W.2d at 719; OCC Interpretive Letter No. 336 from Charles F. Byrd, Assistant Director of the Legal Advisory Services Division (Apr. 16, 1985), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,506.

117. 394 F. Supp. 774.

118. *Id.* at 784 (emphasis supplied).

119. *Miller*, 131 Mich. App. at 773, 347 N.W.2d at 719 (emphasis added).

120. OCC Interpretive Letter No. 336, *supra note* 116, at 77,789.

121. 548 F.2d 255.

122. *Id.* at 260.

123. *Coder*, [1969-1973 Transfer Binder] Cons. Cred. Guide (CCH) para. 99,018 (Mont. Dist. Dec. 29, 1972).

124. Op. Tenn. Att'y Gen. No. 221 (July 30, 1982), *reprinted in* [5] Cons. Cred. Guide (CCH) para. 96,824.

125. *See, e.g., Fisher/Omaha*, 548 F.2d at 260; *Northway Lanes*, 464 F.2d at 862-64; *Danforth*, 394 F. Supp. at 784; *Comm'r*, 268 Md. at 315, 300 A.2d at 691-92; OCC Interpretive Letter No. 255, *supra* note 87.

126. OCC Interpretive Letter No. 255, *supra* note 87.

127. OCC Interpretive Letter No. 333, *supra* note 111.

128. *See e.g.*, Fla. Stat. Ann. § 687.12 (West Cum. Supp. 1987) (as to "loans ... made ... in the State of Florida"); Pa. Stat. Ann. tit. 7, § 6020-101(a)(26) (Purdon Cum. Supp. 1987); Tenn. Code Ann. § 45-4-602(a)(2) (Supp. 1987).

129. *See* Culhane and Kaplinsky, *supra* note 2, at 1336-39.

130. 394 F. Supp. 774.

131. *Id.* at 780-81.

132. *Id.* at 778, 784. The court could instead have interpreted the exemption to prohibit licensed lenders from offering credit sale financing.

133. *Id.* at 784-85.

134. *Id.* at 783. *See supra* text accompanying notes 41-45.

135. *See* Arnold and Rohner, *supra* note 2, at 18.

136. 548 F.2d 255. *See Partain*, 467 F.2d at 173-74 ("[o]bviously, national bank loans are not required in all their characteristics to fit snugly into the mold used by State lending institutions to shape their loans.").

137. 548 F.2d at 259-61.

138. The court is the state's highest court.

139. 294 Md. 385, 450 A.2d 1273.

140. State banks were also party plaintiffs in the case. *Id.* at 388-89, 450 A.2d at 1276-77.

purchases, as opposed to cash advances, are subject to the Retail Credit Accounts Law (RCAL).[141] The court held that unsecured cash advances and credit card purchases constitute different classes of "loans" under section 85 and the OCC Ruling.[142] It distinguished *Danforth* on the basis that the Missouri usury framework discriminated in favor of licensed lenders as to retail sales financing, while Maryland law did not.[143] The *Equitable Trust* court criticized *Fisher/Omaha* for applying a "transactional homogenization analysis" to compensate for the absence under Nebraska law of the type of discrimination which existed in *Danforth*.[144]

The OCC staff also narrowly construed the "class of loans" test in an opinion letter issued after the *Danforth* opinion but before the *Equitable Trust* decision.[145] It noted that the Michigan Retail Installment Sales Act (RISA) did not apply to transactions involving money, and concluded that a national bank could not apply the RISA's rates to cash advance transactions under a credit card program.[146] Thus, as in *Equitable Trust*, the OCC staff treated credit card cash advances and purchases as different classes of loans. The only distinction is that in Michigan the RISA was inapplicable to loans generally, while in Maryland the RCAL was applicable to lenders in credit sales, a separate class of loan.

This OCC staff letter raises questions concerning the *Danforth* court's application of the OCC Ruling. The *Danforth* court assumed without analysis that Missouri SLA rates were applicable to closed-end and open-end credit sales.[147] Reconciling the *Danforth* and OCC staff approaches ultimately depends on the interpretation of section 85 and the applicability and persuasiveness of the OCC Ruling, *Equitable Trust*, and the OCC staff letter. These matters turn on whether section 85 was designed to achieve parity between national banks and other lenders or transactional homogenization. Based on *Tiffany*, it is clear that competitive equality between national and state banks was not intended when lenders in general could charge a higher rate than state banks.[148] It also is clear that competitive equality between national banks and lenders in general does not exist when the exception clause applies; in that case, only national banks have parity with state banks.[149] In fact, the "any loan . . . or other evidences of debt" language of section 85, when read in light of *Tiffany*, strongly suggests that Congress focused on different classes of lenders, rather than different classes of loans.[150]

On the other hand, national banks inevitably borrow their rates directly or indirectly from, and are thus in an equal competitive position with, some other type of lender.[151] When a state establishes its rate structure according to types of credit transactions rather than groups of lenders, rate parity still should exist among at least some classes of lenders.[152] In this situation, national banks arguably should be limited to the rates prescribed for a particular type of transaction when engaging in such a transaction so as to promote competitive equality.[153] In *Danforth*, however, the court's decision that SLA rates were applicable to credit card purchase transactions necessarily determined that the Missouri rate structure for credit sales was organized by classes of lenders rather than classes of loans. *Danforth* and the OCC letter are consistent because the respective statutory structures differ.

The apparent lesson of *Danforth* and subsequent OCC and court decisions is that there is no generally accepted method of classifying consumer credit transactions. While the *Danforth* court's approach seems more consistent with the language of section 85,[154] a court interested in preserving strict competitive equality based on classes of transactions is likely to opt for the analysis of *Equitable Trust* or the OCC staff letter.[155] National banks therefore should be cautious in selecting a state law from which to borrow rates and terms.

(4) "Material to the Determination of the Interest Rate"

The three-part test of "materiality"[156] established by the Liebesman letter[157] permits an organized examination of the provisions of state law a court would be likely to consider as "material to the determination of the interest rate." Many of the cases discussed below were decided based on an analysis of section 85 rather than the OCC Ruling.[158] Nevertheless, they offer some guidance regarding the scope of state law coverage under the Ruling.

(a) State laws establishing characteristics of loan categories

State laws that establish loan characteristics are clearly "material to the determination of the interest rate." Both the *Equitable Trust*[159] court and the OCC staff[160] have ruled that statutory loan ceilings are material. Similarly, *Equitable Trust*[161] and the OCC staff[162] have considered maximum maturity restrictions material. Finally, provisions establishing classes of borrowers, either according to the class of loan sought[163] or the nature of security required,[164] are material.

141. *Id.* at 406, 450 A.2d at 1285.

142. *Id.* at 413-14, 450 A.2d at 1290. *Cf.* Acker v. Provident Nat'l Bank, 512 F.2d 729, 734 (3d Cir. 1975) (credit card purchase is not a "loan" under Pennsylvania Bank Code).

143. *Id.* at 404-406, 450 A.2d at 1285-86.

144. *Id.* at 408-09, 450 A.2d at 1287. The court even suggested that *Marquette* applied a "class of loans" analysis in describing the rate structures under the Nebraska and Minnesota bank credit card laws. *Id.* at 411-12, 450 A.2d at 1288-89. It seems more likely, however, that the parties and the Court purposely did not mention the rates available under the Minnesota Small Loan Act so as to avoid presenting the issue of whether a national bank may import the rates allowed in the borrower's home state. *Marquette*, 439 U.S. at 308 n.19. In fact, the posture of the case narrowed the issue solely to whether Omaha Bank was "located" in Nebraska under section 85. *Id.* at 308.

145. OCC Interpretive Letter No. 178, *supra* note 78.

146. *Id.* at 77,390. The letter also admonished the bank "to establish controls to ensure that higher rates are not charged on excluded transactions." *Id.* at 77,390-91.

147. *See supra* note 132 and accompanying text. *See also* Arnold and Rohner, *supra* note 2, at 20.

148. *See supra* text accompanying notes 21-22.

149. *See supra* text accompanying notes 27-28.

150. *See supra* text accompanying notes 80-81. *But see* Northway Lanes, 464 F.2d at 862 (citing Cong. Globe, 38th Cong., 1st Sess. 2123-26 (1864) (remarks of Sen. Grimes)).

151. *See supra* text accompanying notes 66-72. *See also infra* text accompanying notes 383-408 regarding the extent to which section 521 of DIDMCA, 12 U.S.C. § 1831d (1982), was intended to accord state banks rate-charging parity with national banks.

152. A case could occur where all classes of lenders except one (i.e., small loan law licensees) are prohibited from engaging in a certain kind of transaction (i.e., a $500 loan) at the highest available rate. *See supra* note 129. Even in this case, however, a national bank is entitled to borrow the small loan licensees' rate.

153. *See* Arnold and Rohner, *supra* note 2, at 20.

154. *See supra* text accompanying notes 80-81 & 150.

155. *See supra* text accompanying notes 77-78 & 151-153.

156. *See supra* text accompanying note 99.

157. *Supra* note 98.

158. Several state courts have applied the "materiality" test in cases involving state banks which sought to operate as most favored lenders. *See Equitable Trust*, 294 Md. 385, 450 A.2d 1273. *See also infra* text accompanying notes 421-430.

159. 294 Md. at 419, 450 A.2d at 1292.

160. OCC Interpretive Letter No. 178, *supra* note 78, at 77,391.

161. 294 Md. at 421-22, 450 A.2d at 1293-94. The court applied a closed-end loan maturity provision to open-end credit card transactions.

162. OCC Interpretive Letter No. 333, *supra* note 111.

163. *Id.* (purchase money loans); Liebesman letter, *supra* note 98 (consumer loans versus business loans).

164. OCC Interpretive Letter No. 333, *supra* note 111 (first lien on residential property that is borrower's principal dwelling).

(b) State laws establishing manner in which numerical rate is determined.

Except where otherwise noted, the courts or the OCC have determined that rate computation laws are "material" to the rate determination. In two separate letters, the OCC staff has stated that the authority to charge a variable interest rate[165] and the provisions that restrict the variation of the rate[166] are material.

The leading case for the proposition that a restriction or prohibition against compounding interest is, in effect, material is *Citizens' National Bank v. Donnell.*[167] The Supreme Court held in *Donnell* that the bank violated a state law prohibiting the compounding of interest more than once a year even though the rate remained within the usury limit.[168] The Courts of Appeals for the Third[169] and Fifth[170] Circuits have followed *Donnell.*

Court decisions also indicate that state restrictions on day-count methods are material. In *American Timber & Trading Co. v. First National Bank,*[171] the Ninth Circuit held that a national bank may not use the 365/360 day-count method when that method would yield a rate in excess of the state usury limit.[172] Conversely, a federal district court upheld the use of the 365/360 method where permitted by state law.[173] Additionally, the OCC staff has permitted national banks to use the 365/360 method in calculating interest pursuant to the option in section 85 permitting national banks to charge one percent over the discount rate.[174]

Finally, concerning miscellaneous rate calculation issues, the *Equitable Trust* court held that the after maturity rate, which would take effect six months following the maturity date of a loan, was material.[175] Moreover, the OCC staff has suggested that a national bank may be entitled to charge the rate permitted by state law at the time a loan commitment is made, rather than the lower rate authorized at closing.[176]

(c) State laws affecting ultimate return on loan proceeds

(i) Discounting interest

The controversy concerning whether and to what extent section 85 authorizes the charging of discount interest and therefore preempts conflicting state laws is one of the most important unresolved issues in the interstate lending area. It has highlighted the most fundamental issue in this area: to what extent is state law incorporated in section 85?[177] Although discounting clearly is a rate calculation issue, and thus normally would fit into the Liebesman letter's second category,[178] this controversy and the larger issue of the reach of state law caused Liebesman to create a third category covering state law provisions which merely affect the yield on loan proceeds.[179]

The case which engendered this controversy is the 1919 decision in *Evans v. National Bank.*[180] In *Evans*, the Supreme Court held that a national bank may discount short-term single payment commercial paper at the maximum rate permitted by state law, although the effective rate will exceed the usury limit.[181] The Court relied on its earlier decisions in *Farmers' & Mechanics' National Bank v. Dearing*[182] and *National Bank v. Johnson*[183] for the proposition that the National Bank Act adopts state laws only to the extent that they fix the numerical rate of interest.[184] Another pre-*Evans* line of cases[185] culminating in *Citizens' National Bank v. Donnell*[186] provides that the intent of section 85 is to adopt state law generally.

This dichotomy apparently was submerged for more than fifty years until it reemerged in *Northway Lanes v. Hackley Union National Bank & Trust Co.*[187] and *First National Bank v. Nowlin.*[188] Michigan law permitted discounting, so the Sixth Circuit in *Northway Lanes* did not have to confront limiting *Evans.* Nevertheless, the court observed that under the reasoning of *Evans*, the right to charge interest in advance "arises independent of state laws which are binding on state banks."[189] In contrast, the Eighth Circuit in *Nowlin* faced the issue and limited *Evans* to "its own facts of single payment short-term paper."[190] The court therefore held that a national bank violated Arkansas usury law by discounting interest at the maximum rate on an installment loan.[191] The OCC has issued two staff letters since *Northway Lanes* and *Nowlin* that discuss discounting. The first provides that national banks may discount interest pursuant to the option in section 85 permitting national banks to charge one percent over the discount rate.[192] The latter declines to determine whether a national bank may discount interest on installment loans when its state-chartered competitors cannot.[193]

Although section 85 is not clear regarding national banks' authority to discount interest, the National Bank Act taken as a whole and the federal preemption incorporated in the Act support discounting of interest at the maximum rate allowed by state law. The "powers" section of the National Bank Act specif-

165. OCC Interpretive Letter No. 354 from Roberta W. Boylan, Director of the Legal Advisory Services Division (Nov. 18, 1985), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,524 (equates variable rate lending authority with absence of restriction on frequency of rate changes, but locates "no judicial pronouncements on point."). *See Hiatt*, 361 F.2d at 507 (even where national and state banks were exempt from state usury laws, a "rate" was "fixed" by state law under section 85).

166. OCC Interpretive Letter No. 333, *supra* note 111.

167. 195 U.S. 369 (1904) (decided under section 85).

168. *Id.* at 374.

169. Haas v. Pittsburgh Nat'l Bank, 526 F.2d 1083, 1094-95 (3d Cir. 1975) (decided under section 85); Acker, 512 F.2d at 740-42 (decided under section 85).

170. *Partain*, 467 F.2d at 173-78 (national bank may "borrow" appropriate state law, but still violate state's prohibition against compounding) (decided under section 85). *But see* Fourchon, Inc. v. Louisiana Nat'l Leasing Corp., 723 F.2d 376, 382-86 (5th Cir. 1984) (interest chargeable as agreed by the parties under Preferred Ship Mortgage Act, 46 U.S.C. § 926(d) (1982), so national bank not bound by state restrictions on compounding).

171. 511 F.2d 980 (9th Cir. 1973) *cert. denied*, 421 U.S. 921 (1974) decided under section 85).

172. 511 F.2d at 983-85.

173. Voitier v. First Nat'l Bank, 514 F. Supp. 585, 594 (E.D. La. 1981).

174. OCC Interpretive Letter No. 102 from John E. Shockey, Chief Counsel (May 30, 1979), *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,177.

175. 294 Md. at 419-20, 450 A.2d at 1293.

176. OCC Interpretive Letter No. 81 from Richard V. Fitzgerald, Director of the Legal Advisory Services Division (Feb. 8, 1979), *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,156.

177. *See supra* text accompanying notes 38-40, 48-51, & 100-104.

178. *See supra* text accompanying note 99.

179. *See supra* text accompanying notes 99-105.

180. 251 U.S. 108.

181. *Id.* at 114.

182. 91 U.S. 29.

183. 104 U.S. 271.

184. 251 U.S. at 111.

185. *Daggs*, 177 U.S. 549; *Union Nat'l Bank*, 163 U.S. 325.

186. 195 U.S. 369 (compounding).

187. 464 F.2d 855.

188. 590 F.2d 872.

189. 464 F.2d at 860-61. *See Ray*, 443 F. Supp. at 887-88 (relied on *Northway Lanes*).

190. 590 F.2d at 876.

191. *Id.* at 876-80. *See* Cohen v. District of Columbia Nat'l Bank, 382 F. Supp. 270, 283-84 (D.D.C. 1974) (combination of discounting with interest-only installment payments at maximum rate held usurious) (decided under section 85).

192. OCC Interpretive Letter No. 101 from John E. Shockey, Chief Counsel (May 9, 1979), *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,176.

193. *Id.* No. 115 from Ford Barrett, Assistant Chief Counsel (August 10, 1979), *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,190.