The Scope of Exportation: Some Unresolved Issues After *Smiley v. Citibank*

*By Jeffrey I. Langer**

INTRODUCTION

In the most important interstate lending court decision in nearly two decades,[1] *Smiley v. Citibank (South Dakota), N.A.*,[2] the U.S. Supreme Court upheld the authority of national banks to "export" loan fees deemed by an Interpretive Ruling of the Office of the Comptroller of the Currency (OCC)[3] to constitute "interest" under section 30 of the National Bank Act (NBA) (12 U.S.C. § 85 or section 85).[4] The Court's decision in *Smiley* culminated nearly a decade of litigation[5] concerning whether, and to what extent, national banks and other federally chartered or federally insured

*Mr. Langer, a member of the Ohio and Illinois bars, practices law with Dreher Langer & Tomkies L.L.P. in Columbus, Ohio. He is the chair of the Interest Rate Regulation Subcommittee of the Consumer Financial Services Committee of the Section of Business Law.

1. *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 313-19 (1978) (authorizing national banks to export numerical periodic interest rates).

2. 116 S. Ct. 1730 (1996).

3. 61 Fed. Reg. 4849, 4869 (1996) (to be codified at 12 C.F.R. § 7.4001(a)).

4. 12 U.S.C. § 85 (1994). Section 30 of the NBA 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 title 62 of the Revised Statutes. 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.

5. *Iowa ex rel. Miller v. First National Bank*, Civ. No. 88-20 (D. Del., filed Jan. 19, 1988, dismissed Apr. 15, 1988) (on file with *The Business Lawyer*, University of Maryland School of Law), was the first such suit filed.

financial institutions may impose fees allowed by the laws of the state where the institution is "located" as interest on loans to borrowers residing in other states, i.e., whether they may "export" fees on interstate loans.

Smiley conclusively resolves that national banks have the authority to export fees that are deemed interest under OCC Interpretive Rule 7.4001 (OCC Ruling),[6] including the credit card late fees at issue in the case,[7] if the law of the state where the bank is located permits its most favored lender to charge the fees.[8] The U.S. Supreme Court endorsed as "reasonable" the OCC's interpretation of the term "interest" in section 85.[9] This principle applies to all types of loans made by national banks, whether they are consumer or commercial,[10] closed-end or open-end, or secured or unsecured.

6. The OCC Ruling provides, in pertinent part:

> (a) *Definition.* The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

61 Fed. Reg. at 4869 (to be codified at 12 C.F.R. § 7.4001(a)).

7. *Smiley*, 116 S. Ct. at 1732.

8. The OCC Ruling further provides:

> (b) *Authority.* A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a national bank making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a national bank may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies.
>
> (c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

61 Fed. Reg. at 4869 (to be codified at 12 C.F.R. § 7.4001(b), (c)).

9. *Smiley*, 116 S. Ct. at 1735.

10. Subsection (d) of the OCC Ruling provides that "[a] national bank located in a state

Nonetheless, the *Smiley* decision leaves a number of important interstate lending and bank administrative law issues unresolved. This Article will examine several of the key unresolved interstate lending issues in the wake of *Smiley*.

WHICH FEES ARE AND ARE NOT "INTEREST" UNDER THE OCC RULING?

Although the OCC Ruling establishes a broad federal law definition of interest, the definition is not unrestricted. The OCC Ruling provides that interest under section 85 includes "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended," including, without limitation, "numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees."[11] The term, however, "does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports."[12] The U.S. Supreme Court characterized non-interest charges as encompassing "reimbursement of the lender's costs in processing the application, insuring the loan, and appraising the collateral."[13] The Court distinguished non-interest charges, "those charges that are specifically assigned to" the lender's expenses previously listed, from interest charges, "those that are assessed for simply making the loan, or for the borrower's default."[14]

The OCC Ruling indicates that the OCC's list of fees that constitute interest is not intended to be exhaustive.[15] Accordingly, fees other than those listed may constitute interest, so long as they are not among the fees determined to be non-interest charges by the OCC.[16] A number of credit

the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by a corporate borrower." 61 Fed. Reg. at 4869 (to be codified at 12 C.F.R. § 7.4001(d)).

11. *Id.* (to be codified at 12 C.F.R. § 7.4001(a)).

12. *Id.*

13. *Smiley*, 116 S. Ct. at 1734.

14. *Id.*

15. The OCC Ruling provides that interest under § 30 of the NBA includes, "among other things," certain enumerated fees. 61 Fed. Reg. at 4869 (to be codified at 12 C.F.R. § 7.4001(a)).

16. *See supra* text accompanying notes 11-12. Since the *Smiley* decision, the OCC has opined in an interpretive letter that prepayment fees or penalties levied by a national bank on home equity loans constitute interest under 12 U.S.C. § 85 because, *inter alia*, the fees represent "compensation to the bank, in the form of an alternative to higher finance charges, for the risk that an extension of credit will be repaid prior to the maturity date on which the interest rate was predicated." OCC Interpretive Letter No. 744 from Julie L. Williams, Chief Counsel, [Current] Fed. Banking L. Rep. (CCH) ¶ 81-109, at 90,245-46 (Aug. 21, 1996) (footnote omitted).

card and other loan fees do not fall neatly into either category. For instance, attorneys' fees and collection costs are assessed because of "default or breach by a borrower of a condition upon which credit was extended," but they may not be a "payment compensating a creditor or prospective creditor" (as opposed to a third party) for nonpayment of a loan.[17] Similarly, loan application fees may compensate a creditor or prospective creditor for making a line of credit available, but the *Smiley* Court declared that charges assigned to reimbursement of the lender's costs in processing the application do not constitute interest under the OCC Ruling.[18] Among the other fees that may not be considered interest under section 85 are credit card replacement fees, copy fees, currency conversion fees, line of credit access, check stop payment fees, security interest filing, release or termination fees, and other types of secured loan closing and post-closing costs and fees.

Finally, certain fees and charges appear not to constitute interest under the OCC Ruling, although banks may have considered them interest under section 85 and the federal usury preemption provisions applicable to federally insured state-chartered banks (section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA)[19]) and federally insured savings associations (section 4(g) of the Home Owners' Loan Act of 1933 (HOLA)[20]). These charges fall into two categories. First,

17. *See* 61 Fed. Reg. at 4869 (to be codified at 12 C.F.R. § 7.4001(a)).

18. *Smiley*, 116 S. Ct. at 1734.

19. Pub. L. No. 96-221, § 521, 94 Stat. 164 (1980) (codified at 12 U.S.C. § 1831d (1994)). Section 521 of the DIDA provides, in pertinent part:

> In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at 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) (1994).

20. Pub. L. No. 101-73, § 301, 103 Stat. 280 (1989) (codified at 12 U.S.C. § 1463(g) (1994)). Section 4(g) of the HOLA provides, in pertinent part:

> (g) Preemption of State usury laws
>
> (1) Notwithstanding any State law, a savings association may charge interest on any extension of credit at a rate of not more than 1 percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal

because "premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit" are not interest in the OCC's view,[21] credit insurance charges, real estate mortgage insurance premiums, and other fees paid to third parties who guarantee or insure repayment of loans if the borrower should default likely are not interest under section 85.[22] Second, "finders' fees" also do not constitute interest under the OCC Ruling.[23] Consequently, mortgage broker and other loan broker fees denominated as such are not likely to be interest under section 85. The effect of classifying these two types of charges as non-interest charges may be to encourage banks to impose larger loan origination or cash advance fees (which are likely or certain, respectively, to be characterized as interest under section 85) or higher periodic interest rates in lieu of such non-interest charges.

WHAT IS THE SCOPE OF FEE EXPORTATION BY STATE-CHARTERED BANKS AND FEDERALLY AND STATE-CHARTERED SAVINGS ASSOCIATIONS?

Given that the *Smiley* decision is based upon the U.S. Supreme Court's deference to the OCC's interpretation of section 85, it is not dispositive as to whether federally insured state-chartered banks and federally chartered and federally insured state-chartered savings associations may export late fees and other loan fees. There are, nonetheless, several grounds for concluding that the fee exportation rights of these institutions should be equivalent to those of national banks. First, the only lower court to interpret *Smiley* with respect to state-chartered banks, the New Jersey Supreme Court, has concluded in *Hunter v. Greenwood Trust Co.*[24] that state-chartered banks possess the same fee exportation rights as national banks, at least concerning late fees.

Second, both the Federal Deposit Insurance Corporation (FDIC)[25] and the Office of Thrift Supervision (OTS)[26] have issued interpretations pro-

> Reserve district in which such savings association is located or at the rate allowed by the laws of the State in which such savings association is located, whichever is greater.

12 U.S.C. § 1463(g)(1).

21. *See supra* note 6.

22. *See* Doe v. Norwest Bank Minnesota, N.A., No. 96-1763, 1997 WL 82617 (8th Cir. Feb. 28, 1997) (holding that collateral protection insurance premiums charged to the borrower's account did not constitute interest under 12 U.S.C. § 85 (1994)).

23. *See supra* note 6.

24. 679 A.2d 653 (N.J. 1996), *reinstating* 640 A.2d 855 (N.J. Super. Ct. App. Div. 1994).

25. FDIC Letter No. 92-47 from Douglas H. Jones, Dep. Gen. Counsel, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (July 8, 1992) [hereinafter Jones 1992 FDIC Letter].

26. The OTS interpretation consists of an interpretive ruling on most favored lender usury preemption (OTS Most Favored Lender Ruling). 61 Fed. Reg. 50,951, 50,967-68 & n.63,

viding that federally insured state banks and federally insured savings associations, respectively, may export the same fees on credit card loans as national banks. In fact, the FDIC[27] and the OTS[28] have consistently interpreted section 521 of the DIDA and section 4(g) of the HOLA to grant the institutions that they regulate most favored lender status: in effect,

50,981 (1996) (to be codified at 12 C.F.R. § 560.110). The OTS Most Favored Lender Ruling provides:

> (a) *Definition.* The term "interest" as used in 12 U.S.C. 1463(g) includes any payment compensating a creditor or prospective creditor for an extension of credit, making available a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.
> (b) *Authority.* A savings association located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a federal savings association making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a federal savings association may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of the loans made by small loan companies. Except as provided in this paragraph, the applicability of state law to Federal savings associations shall be determined in accordance with § 560.2 of this part. State supervisors determine the degree to which state-chartered savings associations must comply with state laws other than those imposing restrictions on interest, as defined in paragraph (a) of this section.
> (c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a savings association is located but state law permits its most favored lender to charge late fees, then a savings association located in that state may charge late fees to its intrastate customers. The savings association may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the savings association is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

Id. at 50,981 (to be codified at 12 C.F.R. § 560.110); *see also* OTS Op. 94/CC-18 from Karen Solomon, Dep. Chief Counsel, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,852 (Sept. 29, 1994) (attaching Federal Home Loan Bank Board (predecessor to OTS) Interpretive Letter from Harry W. Quillian (June 27, 1986)).

27. Jones 1992 FDIC Letter, *supra* note 25; FDIC Letter No. 83-16 from Peter M. Kravitz, Senior Att'y, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,013 (Oct. 20, 1983); FDIC Letter No. 81-7 from Kathy A. Johnson, Att'y, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,008 (Mar. 17, 1981).

28. *See supra* note 26.

parity with national banks. Indeed, the OTS has adopted a definition of "interest" under section 4(g) that is identical to that in the OCC Ruling and presumably would receive deference from the U.S. Supreme Court.

Finally, sections 521 and 4(g) should be interpreted to have the same meaning as section 85 with respect to the term "interest" because the operative language of all three provisions, i.e., the authority to "charge interest at the rate allowed by the laws of the state where the institution is located," is virtually identical. Indeed, the U.S. Court of Appeals for the First Circuit in *Greenwood Trust Co. v. Massachusetts*[29] determined that "[t]he historical record clearly requires a court to read the parallel provisions of [the] DIDA and [section 85] *in pari materia.*"[30] After *Smiley*, to heighten the likelihood of judicial deference to its position, the FDIC would be well advised to adopt an interpretive ruling concerning the definition of "interest" and most favored lender status under section 521 that is coextensive with the OCC Ruling.[31]

SCOPE OF INCORPORATION OF A NATIONAL BANK'S HOME STATE'S LAW IN SECTION 85: WHAT PROVISIONS ARE "MATERIAL TO THE DETERMINATION OF THE PERMITTED INTEREST" AND ARE THOSE PROVISIONS EXPORTABLE?

The courts and the OCC staff have differed as to whether the state law incorporated in section 85 encompasses only the numerical rate of interest,[32] or if it includes the method of calculating the rate as well,[33] or even the entire case law interpreting limitations on usury,[34] including common law conflict-of-laws rules.[35] Even the U.S. Supreme Court has been unable

29. 971 F.2d 818 (1st Cir. 1992).

30. *Id.* at 827. Those "parallel provisions" include not only § 521 but also § 522 (now § 4(g) of the HOLA) and § 523 (regarding federally chartered and federally insured state-chartered credit unions)). *See* 12 U.S.C. §§ 1463(g), 1785(g), 1831d (1994).

31. *See* Smiley v. Citibank (South Dakota), N.A., 116 S. Ct. 1730, 1735 (1996); *see also* OTS Most Favored Lender Ruling, 61 Fed. Reg. at 50,981 (to be codified at 12 C.F.R. § 560.110).

32. Evans v. Nat'l Bank, 251 U.S. 108, 111 (1919); *see* Nat'l Bank v. Johnson, 104 U.S. 271, 277-78 (1881); Farmers' & Mechanics' Nat'l Bank v. Dearing, 91 U.S. 29, 34 (1875).

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

34. First Nat'l Bank v. Nowlin, 509 F.2d 872, 876 (8th Cir. 1975); *see* Union Nat'l Bank v. Louisville, New Albany & Chicago Ry., 163 U.S. 325, 331 (1896); OCC Interpretive Letter No. 452 from Robert B. Serino, Dep. Chief Counsel (Policy), [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 (Aug. 11, 1988) [hereinafter Serino 1988 OCC Letter].

35. OCC Interpretive Letter No. 325 from Peter Liebesman, Asst. Dir., Legal Advisory Servs. Div., [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,495, at 77,754 (Jan. 22, 1985); *see* Hershel Shanks, *Special Usury Problems Applicable to National Banks*, 87 BANKING L.J. 483, 489-91 (1970). *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).

to agree on the scope of incorporation of a national bank's home state's law in section 85.[36] Unfortunately, the OCC Ruling does not resolve the extent of this incorporation. The ruling merely provides that home state law determines the rate and amount of interest that a national bank may impose, and federal law determines what constitutes interest.[37] The resolution of this issue is important because it will determine the scope of home state law with which a national bank must comply and, thus, may be able to export on its interstate loans.

The courts and the OCC staff have determined on numerous occasions that laws of a national bank's home state that establish the manner in which the rate of interest is calculated apply under section 85 in intrastate loans.[38] In effect, these cases and interpretive letters have concluded that, in the language of the OCC Ruling, these statutory provisions are "material to the determination of the permitted interest."[39] Among the provisions that have been found to be material are prohibitions or restrictions against compounding interest,[40] authorizations to vary and restrictions on the variation of the rate,[41] and restrictions on day-count methods.[42] Neither the courts nor the OCC, however, have addressed whether other provisions that restrict the amount or the timing of collection of interest are material. Thus, there is no guidance regarding the materiality of such

36. *See supra* notes 33-34.

37. *See supra* note 3; *see also* OCC Interpretive Letter No. 670 from Julie L. Williams, Chief Counsel, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618, at 71,834 n.3 (Feb. 17, 1995).

38. *See* Jeffrey I. Langer & Jeffrey B. Wood, *A Comparison of the Most Favored Lender and Exportation Rights of National Banks, FSLIC-Insured Savings Institutions, and FDIC-Insured State Banks*, 42 CONSUMER FIN. L.Q. REP. 4, 12 (1988). *See generally* OCC Interpretive Letter from Peter C. Liebesman, Asst. Dir., Legal Advisory Servs. Div., 1983 WL 145788 (O.C.C.) (Feb. 4, 1983) [hereinafter Liebesman 1983 OCC Letter].

39. 61 Fed. Reg. 4849, 4869 (1996) (to be codified at 12 C.F.R. § 7.4001(b)).

40. Citizens Nat'l Bank v. Donnell, 195 U.S. 369, 373-74 (1904); Haas v. Pittsburgh Nat'l Bank, 526 F.2d 1083, 1094-95 (3d Cir. 1975); Acker v. Provident Nat'l Bank, 512 F.2d 729, 740-42 (3d Cir. 1975); Partain v. First Nat'l Bank, 467 F.2d 167, 173-78 (5th Cir. 1972). *But see* Fourchon, Inc. v. Louisiana Nat'l Leasing Corp., 723 F.2d 376, 382-86 (5th Cir. 1984) (finding the interest was chargeable as agreed by the parties under the Preferred Ship Mortgage Act, 46 U.S.C. § 926(d) (1982), so the national bank was not bound by state restrictions on compounding).

41. OCC Interpretive Letter No. 354 from Roberta W. Boylan, Dir., Legal Advisory Servs. Div., [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,524, at 77,816 (Nov. 18, 1985) [hereinafter Boylan 1985 OCC Letter] (equating variable rate lending authority with absence of restrictions on frequency of rate changes but locates "no judicial pronouncements on point"); OCC Interpretive Letter No. 333 from Charles F. Byrd, Asst. Dir., Legal Advisory Servs. Div., [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,503, at 77,785 (Mar. 20, 1985) [hereinafter Byrd 1985 OCC Letter] (stating that material restrictions include "annual and life-of-loan interest rate caps, restrictions on the frequency of interest rate changes, and restrictions on the permissible index").

42. American Timber & Trading Co. v. First Nat'l Bank, 511 F.2d 980, 983-85 (9th Cir. 1973); Voitier v. First Nat'l Bank of Commerce, 514 F. Supp. 585, 594 (E.D. La. 1981).

terms as balance calculation methods, the grace period for repayment of account balances, grace periods and notice requirements for assessment of late fees and returned check fees, and (except insofar as the OCC staff letters on variable rate authority are deemed applicable to changes in fixed interest terms) restrictions on the timing of changes in terms, e.g., effective dates and retroactive effect.

Because national banks and other financial institutions with fee exportation rights may, in the wake of *Smiley*, seek to increase the dollar or percentage amounts of fees they have been imposing or impose new fees, the question of whether and to what extent they must comply with state change-of-terms notice requirements and restrictions has become particularly important. If such an institution has included a governing law provision in its open-end credit agreements selecting its home state's law (and federal law) or if change-of-terms requirements are material,[43] the institution must comply with any such home state requirements. Moreover, the loan agreement may impose restrictions on the institution's authority to change terms. To the extent the borrower's state's law impedes the bank's or thrift's ability to charge interest under federal law to a greater extent than either the contractual governing law or the contractual change-of-terms provision, it can be argued that the borrower state change-of-terms restriction should be preempted. Of course, if the contract allows unilateral changes of terms without restriction, under common law principles, there is no enforceable agreement either at inception or for the new terms.[44] National banks and other "exporting" lenders should review their loan contracts and manner of changing terms to assess the enforceability and preemptive scope of their change-of-terms structures.

In its recently promulgated interpretive rulings, which included the OCC Ruling, the OCC has delineated a final set of terms that may be "material to the determination of the permitted interest": non-interest charges and fees.[45] OCC Interpretive Rule 7.4002 declares that "[a] na-

43. The OTS Most Favored Lender Ruling adopts the OCC Ruling's "materiality" test with respect to federal savings associations. In the case of state-chartered savings associations, this ruling provides that "[s]tate supervisors determine the degree to which [such] associations must comply with state laws other than those imposing restrictions on interest, as defined in [the ruling]." 61 Fed. Reg. 50,951, 50,981 (to be codified at 12 C.F.R. § 560.110(b)). With respect to national banks, the "federal instrumentality" doctrine also may make home state law applicable. *See infra* text accompanying notes 52-56. With respect to federally insured state banks, the "materiality" test has been applied. *See, e.g.*, Attorney Gen. v. Equitable Trust Co., 450 A.2d 1273 (Md. 1982).

44. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 1, 22, 33-34 (1979).

45. 61 Fed. Reg. 4849, 4869-70 (1996) (to be codified at 12 C.F.R. § 7.4002). The ruling provides, in pertinent part:

> (a) *Customer charges and fees.* A national bank may charge its customers non-interest charges and fees, including deposit account service charges. For example, a national bank may impose deposit account service charges that its board of directors determines to be reasonable on dormant accounts. A national bank may also charge a borrower reason-

tional bank may charge its customers non-interest charges and fees, including . . . reasonable fees for credit reports or investigations with respect to a borrower's credit."[46] These fees may be merely illustrative of non-interest fees that a national bank may impose; accordingly, all non-interest fees may be subject to Interpretive Rule 7.4002. This rule requires that such fees (i) "be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks"[47] and (ii) be reasonably established.[48] To "reasonably establish" such fees, a national bank must consider the following factors, among others: (i) the cost incurred by the bank, plus a profit margin, in providing the service; (ii) the deterrence of misuse by customers of banking services; (iii) the enhancement of the bank's competitive position in accordance with its marketing strategy; and (iv) the maintenance of the bank's safety and soundness.[49]

These fees may be material on the bases that they are permitted by a national bank's home state's law and the legislature presumably considered the amounts of such fees when it determined permissible interest charges. Even if non-interest fees are not material, Interpretive Rule 7.4002 provides that the OCC may preempt contrary state law limitations on such fees on a case-by-case basis.[50] In making such determinations, the OCC

> able fees for credit reports or investigations with respect to a borrower's credit. All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.
>
> (b) *Considerations.* The establishment of non-interest charges and fees, and the amounts thereof, is a business decision to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A bank reasonably establishes non-interest charges and fees if the bank considers the following factors, among others:
>
> (1) The cost incurred by the bank, plus a profit margin, in providing the service;
>
> (2) The deterrence of misuse by customers of banking services;
>
> (3) The enhancement of the competitive position of the bank in accordance with the bank's marketing strategy; and
>
> (4) The maintenance of the safety and soundness of the institution.
>
> (c) *Interest.* Charges and fees that are "interest" within the meaning of 12 U.S.C. 85 are governed by § 7.4001 and not by this section.
>
> (d) *State law.* The OCC evaluates on a case-by-case basis whether a national bank may establish non-interest charges or fees pursuant to paragraphs (a) and (b) of this section notwithstanding a contrary state law that purports to limit or prohibit such charges or fees. In issuing an opinion on whether such state laws are preempted, the OCC applies preemption principles derived from the Supremacy Clause of the United States Constitution and applicable judicial precedent.

Id. (to be codified at 12 C.F.R. § 7.4002(a)-(d)).

46. *Id.* (to be codified at 12 C.F.R. § 7.4002(a)).
47. *Id.*
48. *Id.* (to be codified at 12 C.F.R. § 7.4002(b)).
49. *Id.*
50. *Id.* (to be codified at 12 C.F.R. § 7.4002(d)).

is to apply "preemption principles derived from the Supremacy Clause of the United States Constitution and applicable judicial precedent."[51] In the case of national banks, one of these principles consists of the "federal instrumentality" doctrine: national banks are subject to state law except to the extent that such law conflicts with, or frustrates the purpose of, federal legislation, i.e., the NBA, or disrupts the banks' performance of their duties as federal instrumentalities.[52] The federal instrumentality doctrine appears to operate independently of the OCC Ruling's materiality standard to make national banks subject to additional non-material provisions of home state and borrower state laws.[53] If the bank's loan agreements select its home state's law as the governing law, the bank, in any case, will have to comply with all applicable provisions of such law.

There are several provisions of state law that have been found not to be material to the determination of the rate of interest which may be imposed by a national bank. In the leading case on materiality, *Attorney General v. Equitable Trust Co.*,[54] Maryland's highest court[55] ruled that a provision subjecting the lender to the borrower's claims and defenses against a seller of goods was not material. Additionally, on two occasions, the OCC staff has concluded that state disclosure requirements are not material.[56]

The OCC Ruling also fails to state whether or not material terms are exportable in addition to interest. Construing former OCC Interpretive Rule 7.7310,[57] the interpretive rule on most-favored-lender status supplanted by the OCC Ruling, the OCC staff declared in several interpretive letters that material provisions are exportable.[58] A strong argument can be made that at least those provisions of a national bank's home state's law that determine the rate or amount of interest which the bank may impose should be exportable. The courts should consider the calculation

51. *Id.*

52. *See* Anderson Nat'l Bank v. Luckett, 321 U.S. 233, 247-53 (1944); First Nat'l Bank v. Missouri, 263 U.S. 640, 656 (1924); Davis v. Elmira Sav. Bank, 161 U.S. 275 (1896).

53. *See* Langer & Wood, *supra* note 38, at 9.

54. 450 A.2d 1273 (Md. 1982).

55. Maryland's highest court is the court of appeals.

56. Byrd 1985 OCC Letter, *supra* note 41, at 77,785 (noting that, based on federal instrumentality doctrine, in the absence of a federal statute or regulation, national banks remain subject to the law applicable to them, including disclosure requirements); OCC Interpretive Letter No. 178 from Richard V. Fitzgerald, Dir., Legal Advisory Servs. Div., [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,259 (Jan. 12, 1981). The OTS has found a state law prohibiting fraudulent and deceptive practices not to be material or otherwise preempted under its Interpretive Ruling on Lending and Investment, including the OTS Most Favored Lender Ruling. 61 Fed. Reg. 50,951, 50,972, 50,981 (1996) (to be codified at 12 C.F.R. §§ 560.2, 560.110); OTS Opinion Letter from Carolyn J. Buck, Chief Counsel, [Current] Fed. Banking L. Rep. (CCH) ¶ 83-106, at 94,226-27 (Dec. 24, 1996).

57. 12 C.F.R. § 7.7310 (1996), *repealed and replaced by* 61 Fed. Reg. 4849, 4869 (1996) (to be codified at 12 C.F.R. § 7.4001).

58. *See, e.g.*, Serino 1988 OCC Letter, *supra* note 34; Boylan 1985 OCC Letter, *supra* note 41; Liebesman 1983 OCC Letter, *supra* note 38.

of the permitted interest to be so intimately bound up with the rate of interest as to be exportable with the rate itself.

CONCLUSION

Smiley represents an important victory for national banks and other federally insured financial institutions in their quest to establish uniform nationwide lending programs. Nonetheless, there remain numerous unanswered questions regarding the scope of these institutions' exportation and most-favored-lender rights.