

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

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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 litigation⁵ concerning whether, and to what extent, national banks and other federally chartered or federally insured

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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 FDIC²⁷ and the OTS²⁸ 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).

