Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

Chief Counsel

[redacted]

December 24, 1996

Re: Preemption of State Laws Applicable to Credit Card Transactions

Dear [redacted]

This responds to your inquiry, submitted on behalf of [redacted] (the "Association"), to the Office of Thrift Supervision ("OTS") regarding the application of three specific Indiana laws to the Association's proposed [redacted] credit card loan program. Your inquiry raises issues regarding federal preemption and application of the Most Favored Lender ("MFL") provision of the Home Owners' Loan Act ("HOLA").[1]

In brief, we conclude that federal law does not preempt the cited Indiana law prohibiting fraudulent and deceptive loan practices. Federal law does, however, preempt the cited Indiana laws that pertain to disclosure and loan-related charges (except for charges that constitute "interest" under the MFL provision). Moreover, under the MFL provision, the Association may elect to charge interest (including charges that constitute interest) up to the maximum amount authorized by the laws of Indiana for the state's most favored lender, notwithstanding any contrary provision in Indiana's laws or the laws of any other states where borrowers reside.

I. Background

The Association is a federal savings bank [redacted] located in Indiana. The Association proposes to issue [redacted] credit cards to customers nationwide.

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[1] 12 U.S.C.A. § 1463(g) (West Supp. 1996).

You indicate that the Indiana Uniform Consumer Credit Code (the "UCCC") regulates all persons making consumer loans in Indiana, including unsecured credit card loans.[2] The UCCC addresses two areas: (1) finance charge rates and other charges;[3] and (2) disclosure requirements incorporated from the federal Truth in Lending Act (the "TILA") and Federal Reserve Board Regulation Z.[4] You also represent that the Indiana deceptive acts and practices statute (the "DAP") regulates the activities of lenders by prohibiting specified acts and representations in connection with consumer transactions.[5]

You inquire whether the Association must comply with these three Indiana laws in connection with [redacted] credit card loans issued to borrowers located in Indiana and in other states.

II. Discussion

A complete response to the Association's inquiry requires examination of both HOLA's MFL provision and OTS's lending regulations.

When a savings association issues credit cards, it may utilize the MFL rate authorized by section 4(g) of the HOLA. This provision permits savings associations to charge interest on loans at the most favorable rate allowed any lender by the laws of the state in which the association is located, notwithstanding any contrary state law. Moreover, a savings association may "export" the favorable MFL rate of the location state when making loans to borrowers who

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[2] See Ind. Code § 24-4.5-1-101 et seq. (1995).

[3] Ind. Code § 24-4.5-3-508 (1995), as amended by 750 IAC 1-1-1, provides that the maximum finance charge permissible for supervised consumer loans is 36% for unpaid balances of less than $870; 21% for unpaid balances between $870 and $2,900; and 15% for unpaid loan balances in excess of $2,900.

[4] The UCCC directs the creditor to "disclose to the debtor to whom credit is extended with respect to a consumer loan the information required by the Federal Consumer Credit Protection Act." Ind. Code § 24-4.5-3-301(2) (1995). The UCCC defines "Federal Consumer Credit Protection Act" to mean the federal Truth in Lending Act (15 U.S.C.A. § 1601 et seq.) as amended by the Truth in Lending Simplification and Reform Act (Pub. L. 96-221, 94 Stat. 168), and any regulations issued thereunder. Ind. Code §§ 24-4.5-1-102(4) and 24-4.5-1-302 (1995). Regulation Z implements TILA and is located at 12 C.F.R. Part 225 (1996).

[5] See Ind. Code §§ 24-5-0.5-1 et seq. (1995). For example, the statute prohibits a person who regularly engages in consumer transactions from making representations that "a specific price advantage exists as to [the] subject of the consumer transaction, if it does not and the [person] knows or should reasonably know that it does not" and from making oral or written representations that a consumer transaction involves "rights, remedies or obligations, if the representation is false and if the [person] knows or should reasonably know that the representation is false." Ind. Code § 24-5-0.5-3(6) & (8) (1995).

reside in other states.[6] The practical effect of section 4(g) is to preempt state usury laws to a limited extent.

Beyond the MFL provision, the HOLA also authorizes OTS to promulgate regulations that have preemptive effect. Prior to enactment of the HOLA, "'the states had developed a hodgepodge of savings and loan laws and regulations. . . . [When enacting HOLA,] Congress hoped that [the] . . . rules [of the Federal Home Loan Bank Board and now OTS] would set an example for uniform and sound savings and loan regulation.'"[7] Consistent with this intent, courts have long recognized that federal savings associations are uniquely federalized financial institutions – even more so than national banks.[8] As the Supreme Court has recognized:

> Congress directed that, in regulating federal [savings associations], the [Bank Board and now OTS should] consider "the best practices of local mutual thrift and home financing institutions in the United States," which were at the time all state-chartered. By so stating, Congress plainly envisioned that federal savings [associations] would be governed by what the [Bank Board and now OTS] – not any particular state – deemed to be the best practices, and approved the . . . promulgation of regulations superseding state law. . . .[9]

Consistent with the foregoing, the OTS has authority to issue regulations preempting state laws that affect the operations of federal savings associations.

The OTS and the Bank Board have long taken the position that federal lending laws and regulations are intended to occupy the entire field of lending regulation for federal savings associations, leaving no room for state regulation.[10] For these purposes, the field of lending regulation has been defined to encompass all laws affecting lending by federal thrifts, except certain specified areas where

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6 See Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978).

7 Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979) (citations omitted).

8 People v. Coast Federal Savings and Loan Association, 98 F. Supp. 311, 319 (S.D. Calif. 1951).

9 Fidelity Federal Savings and Loan Association v. de la Cuesta, 458 U.S. 141, 153-154 (1982).

10 For a general discussion of the principles of federal preemption, see OTS Op. Chief Counsel (Oct. 11, 1991).

state law furthers a vital state interest and has only an incidental effect on lending operations.

The preamble to OTS's recent final rule streamlining its lending and investment regulations explains the rationale for this position:

> [I]nstead of being subject to a hodgepodge of conflicting and overlapping state lending requirements, federal thrifts [should] be free to originate loans under a single set of uniform federal laws and regulations. This furthers both the "best practices" and safety and soundness objectives of the HOLA by enabling federal thrifts to deliver low-cost credit to the public free from undue regulatory duplication and burden. At the same time, the interests of borrowers are protected by the elaborate network of federal borrower-protection statutes applicable to federal thrifts . . . . In addition, in those instances where OTS has detected a gap in the federal protections provided to borrowers, the agency has promulgated regulations imposing additional consumer protection requirements on federal thrifts.[11]

Accordingly, OTS has preempted most state laws affecting lending by federal thrifts. This position was previously reflected in the OTS regulation at 12 C.F.R. § 545.2 (1996), has been confirmed and carried forward in OTS's recent final rule updating and streamlining its lending and investment regulations, and will be codified in OTS regulations at 12 C.F.R. § 560.2.[12]

The preamble to OTS's recent final rule describes the analytic framework to be used in determining whether a particular state law that affects lending is, or is not, preempted by federal law. The preamble states:

> When analyzing the status of state laws under § 560.2, the first step will be to determine whether the type of law in question is listed [among the illustrative examples of preempted state laws] in paragraph (b) [of § 560.2]. If so, the analysis will end there; the law is preempted. If the law is not covered by paragraph (b), the next

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[11] 61 Fed. Reg. 50951 at 50965-50966 (Sept. 30, 1996).

[12] See 61 Fed. Reg. at 50972. The preamble to this regulation, which became effective on October 30, 1996, contains an extensive discussion of the scope of, and the legal basis for, the OTS authority to preempt by regulation. See 61 Fed. Reg. at 50965-67. A copy of the preamble is enclosed for your reference.

> question is whether the law affects lending. If it does, then, in accordance with paragraph (a), the presumption arises that the law is preempted. This presumption can be reversed only if the law can clearly be shown to fit within the confines of [the types of state laws not preempted, as described in § 560.2(c)]. For these purposes, paragraph (c) is intended to be interpreted narrowly.[13]

We have examined the three cited Indiana laws under this analytic framework.

A. Interest Rates and Related Charges

The new OTS lending regulation specifically addresses your inquiry regarding federal preemption of state laws regulating interest rates and related charges. The illustrative list of preempted state laws at § 560.2(b) indicates, in subparagraph (12), that state interest rate ceilings are preempted to the extent provided in the MFL provision of the HOLA. Thus, when the Association issues a credit card under the MFL provision, it may "charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of [Indiana]," notwithstanding any contrary provisions in Indiana law or the law of the states where borrowers reside.[14] The OTS MFL regulation defines interest as follows:

> The term 'interest' . . . includes any payment compensating a creditor or prospective creditor for an extension of credit . . . . It includes, among other things, the following fees connected with credit extension or availability: numerical periodic interest 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.[15]

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[13] 61 Fed. Reg. at 50966.

[14] The OTS recently conformed the text of its regulation implementing HOLA § 4(g) to the regulation implementing a similar statutory MFL provision for national banks. See 61 Fed. Reg. at 50981 (to be codified at 12 C.F.R. § 560.110). The Office of the Comptroller of the Currency's ("OCC") rule implementing 12 U.S.C.A. § 85 (West 1989) is found at 61 Fed. Reg. 4849, 4869 (Feb. 9, 1996) (to be codified at 12 C.F.R. § 7.4001).

[15] 12 C.F.R. § 560.110(a).

Loan-related fees not covered by the definition of interest under the MFL provision of the HOLA are governed by subparagraph (5) of § 560.2(b).[16] This provision preempts state laws regulating "loan-related fees, including without limitation, initial charges, late charges, prepayment penalties, servicing fees, and overlimit fees," but does not apply to numerical interest rates. Subparagraph (5) reflects OTS's determination that federal thrifts should be free to contract with customers for fees that are driven by the market for financial services, rather than government regulation, provided adequate loan-fee disclosure is given to consumers (as federal law mandates).

We note that at least one type of fee (late fees) listed as preempted in subparagraph (5) also falls within the scope of the term "interest" under the OTS MFL regulation. Because the statutory MFL provision is a specific expression of Congressional intent, any overlap between that provision and subparagraph (5) must be resolved in favor of the MFL provision whenever a lender originates a loan under the MFL provision. What this means for the Association is as follows.

Indiana's UCCC sets a maximum finance charge for supervised consumer loans that varies based on the amount of the unpaid balance of the loan. Under the UCCC, the finance charge is broadly defined to include "all charges payable directly or indirectly to the lender as an incident to the extension of credit."[17] This language is broad enough to encompass all fees and charges that constitute "interest" under the MFL provision. Thus, when issuing a credit card loan under the MFL provision, the Association must abide by any limits in the Indiana UCCC governing not only the numerical interest rate, but also late fees, NSF fees, overlimit fees, annual fees, cash advance fees, and membership fees.

The Indiana UCCC also purports to apply its usury limits to any charges imposed by the Association "for any guarantee or insurance protecting the lender against the debtor's default or other credit loss; and charges incurred for investigating the collateral or credit-worthiness of the debtor."[18] These charges, however, are expressly excluded from the definition of "interest" under OTS's

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16 See 12 C.F.R. § 560.110(b) ("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.")

17 Ind. Code § 24-4.3-109(1) (1995).

18 Id.

MFL regulation.[19] As provided in the MFL regulation at § 560.110(b), the status of state laws that are not encompassed by the MFL regulation are governed by the general principles of preemption set forth in § 560.2. As noted above, § 560.2(b)(5) preempts state laws that attempt to "impose requirements regarding . . . loan-related fees." This language encompasses fees charged for appraisals required for loan origination and premiums charged for credit insurance.

Thus, when issuing credit cards, the Association will be required to limit all fees and charges that constitute "interest" (as defined in § 560.110(a)) to the maximum rate authorized for Indiana's most favored lender. No other state's laws will apply to these fees and charges, even if the Association's borrowers reside in another state. All state laws that purport to address loan-related fees that are not included within the MFL definition of interest are preempted by federal law.

B. Disclosure Requirements

The new OTS lending regulation also addresses federal preemption of disclosure requirements. Section 560.2(b)(9) provides that state laws imposing lending disclosure and advertising requirements are preempted. State laws within the purview of § 560.2(b)(9) include those that require specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents. The provision of the Indiana UCCC requiring specific lending disclosures by the Association is preempted by this federal regulation.[20] Instead, the Association is required to comply with the elaborate federal network of disclosure laws, including TILA and Regulation Z.[21]

This conclusion is not altered by the fact that the MFL provision will apply to the Association's credit card program. Although institutions utilizing the MFL

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[19] 12 C.F.R. § 560.110(a) (Interest "does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, . . . or fees incurred to obtain credit reports.")

[20] This conclusion is consistent with the agency's longstanding position that state disclosure laws are preempted. See e.g., OTS Op. Dep. Chief Counsel (Oct. 18, 1994) (state law requiring a savings association to provide copies of credit reports held by the savings association); OTS Op. Chief Counsel (Jan. 3, 1991) (state law requiring disclosure of information on escrow accounts for mortgages); FHLBB Op. by Gen. Counsel (Apr. 28, 1987) (state regulations purporting to regulate lending disclosure); and FHLBB Op. by Gen. Counsel (Nov. 12, 1985) (state truth in lending laws).

[21] Because the Indiana law merely incorporates by reference already-applicable federal requirements under TILA and Regulation Z, we recognize that the practical effect of preemption, in this instance, would be negligible.

provision must comply with any provisions of state law that are "material to the determination of the permitted interest rate."[22] Indiana's disclosure laws are not material to this determination.

In the past, state laws have been deemed to be material to the determination of the interest rate in only two instances. First, whenever a state authorizes an interest rate for a particular category of loan, the provisions of law defining the fundamental characteristics of that category of loan must be observed.[23] Second, state laws defining how interest is to be computed must also be observed.[24]

Indiana's UCCC disclosure law, however, neither defines the fundamental characteristics of the category of loans covered by the usury rates in question nor affects the manner of computing the interest rate. Accordingly, the UCCC disclosure law is not material to the interest rate and is not encompassed by the MFL provision.[25]

Thus, general principles of federal preemption determine what disclosure requirements apply to loans made by the Association under the MFL provision.[26] As indicated above, § 560.2(b)(9) preempts the Indiana disclosure law.

You have also asked whether federal law would preempt a cited Ohio disclosure law which requires lenders to provide written statements notifying borrowers of their rights under state anti-discrimination statutes.[27] Specifically, this statute requires that credit application forms (or where there is a multi-state

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22 12 C.F.R. § 560.110(b).

23 See OCC Interpretive Letter No. 354 [1985-87 Transfer Binder] Fed. Bank L. Rep. (CCH) ¶ 85,524. The OTS and the FHLBB have long looked to OCC precedent interpreting the national bank MFL provision for guidance in interpreting section 4(g) and the OTS implementing regulation. See e.g. OTS Op. Chief Counsel, Dec. 24, 1992, pp. 3-4.

24 Id.

25 Accord OCC Interpretive Letter No. 178, [1981-82 Transfer Binder] Fed. Bank. L. Rep. (CCH) ¶ 85,259; OCC Interpretive Letter No. 333, [1985-87 Transfer Binder] Fed. Bank. L. Rep. (CCH) ¶ 85,503. This determination is consistent with the preamble to the OTS regulation which states that a disclosure provision will be material to the determination of the interest rate only in "rare instances." 61 Fed. Reg. 50968. This position reflects a change in the OTS's interpretation of the MFL statute. Under the prior OTS regulation at 12 C.F.R. § 571.22 (1996), thrifts were required to comply with consumer protection laws, including disclosure provisions, of the state in which they were located when making loans under the MFL provision. Id. Under the new regulation, consumer protection laws no longer automatically apply.

26 12 C.F.R. § 560.110(b).

27 Ohio Rev. Code Ann. § 4112.021(g) (Anderson 1996).

distribution, notices of acceptance or rejection of the application) include the following statement: "Ohio laws against discrimination require that all creditors make credit equally available to all credit worthy customers." As already discussed above, the OTS regulation at § 560.2(b)(9) preempts state laws imposing disclosure requirements, including the cited Ohio disclosure law.[28] Accordingly, the Association need not comply with this disclosure provision.

C. Deceptive Acts and Practices Statute

Your final preemption inquiry involves Indiana's DAP law. State laws prohibiting deceptive acts and practices in the course of commerce are not included in the illustrative list of preempted laws in § 560.2(b). Thus, a more extensive preemption analysis of Indiana's DAP statute is required. The DAP statute prohibits specified acts and representations in all consumer transactions without regard to whether the transaction involves an extension of credit.[29] Although not directly aimed at lenders, this law affects lending to the extent that it prohibits misleading statements and practices in loan transactions by a federal savings association. Accordingly, under the analysis described above, a presumption arises that the DAP statute would be preempted in connection with loans made by the Association.

The OTS has indicated, however, that it does not intend to preempt state laws that establish the basic norms that undergird commercial transactions.[30] Accordingly, in § 560.2(c), the OTS has identified certain categories of state law that are not preempted.[31] A state law that falls within the specified categories will not be preempted if the law only incidentally affects the lending operations of federal savings associations, or is otherwise consistent with the objectives that underlie OTS's preemption position, as set forth in paragraph (a) of § 560.2.[32] Paragraph (a) indicates that the OTS's objectives are to facilitate the safe and sound operation of federal savings associations, to enable federal associations to

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[28] We note that the Ohio law is largely duplicative of the disclosure requirement contained in Regulation B which implements the Equal Credit Opportunity Act. See 12 C.F.R. § 202.9(a)(2) (1996). This regulation requires lenders to provide a notice setting forth the protections contained in section 701(a) of the Act "whenever an adverse action is taken with regard to a credit application."

[29] See Ind. Code § 24-5-0.5-2(1) (1995) (definition of consumer transaction).

[30] 61 Fed. Reg. at 50966.

[31] 12 C.F.R. § 560.2(c)(1) through (5). These categories include: contract and commercial law, real property law, homestead laws, tort law and criminal law.

[32] 12 C.F.R. § 560.2(c).

conduct their operations in accordance with best practices of thrift institutions in the United States, and to further other purposes of the HOLA.

The Indiana DAP falls within the category of traditional "contract and commercial" law under § 560.2(c)(1). While the DAP may affect lending relationships, the impact on lending appears to be only incidental to the primary purpose of the statute -- the regulation of the ethical practices of all businesses engaged in commerce in Indiana. There is no indication that the law is aimed at any state objective in conflict with the safe and sound regulation of federal savings associations, the best practices of thrift institutions in the United States, or any other federal objective identified in § 560.2(a). In fact, because federal thrifts are presumed to interact with their borrowers in a truthful manner, Indiana's general prohibition on deception should have no measurable impact on their lending operations. Accordingly, we conclude that the Indiana DAP is not preempted by federal law.[33]

You have asked whether the Association may "export" the Indiana DAP prohibitions when issuing credit cards to borrowers located in other states under the MFL provision. In other words, may the Association comply with Indiana's DAP in lieu of the deceptive practices laws of any other state?

As noted above, only state laws that set the maximum amount of interest or that are material to the determination of interest are covered by the MFL provision. Indiana's DAP does not establish the maximum interest permitted under Indiana law, does not prescribe unique characteristics of a specified class of loans permitted under Indiana law, and does not address the manner in which interest is computed. Accordingly, the DAP is not covered by the MFL provision.

Thus, general principles of federal preemption govern. As indicated above, nothing in federal law preempts general deceptive practices statutes. The Association is required to comply with the Indiana DAP and those deceptive practices statutes of other states that are worded in a manner to apply to the Association's loans. The applicability of conflicting state requirements should be resolved under traditional conflicts of laws principles and may turn on the facts of the specific transaction. Under some circumstances, the deceptive practices laws of more than one state may apply to the same transaction.

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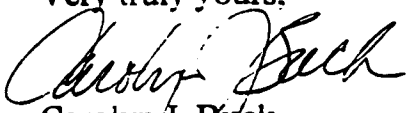
[33] This conclusion is consistent with relevant case law. See Morse v. Mutual Federal Savings and Loan Association of Whittingham, 536 F. Supp. 1271 (D. Mass. 1982) (federal savings associations are subject to a general Massachusetts statute proscribing unfair and deceptive trade practices).

In reaching the foregoing conclusions, we have relied upon the representations made in the materials you submitted and in subsequent discussions. Our conclusions depend upon the accuracy and completeness of those representations. Any material difference in facts or circumstances from those described herein could result in different conclusions.

If you have any questions regarding this matter, please feel free to contact Karen Osterloh, Counsel (Banking and Finance), (202) 906-6639.

Very truly yours,



Carolyn J. Buck
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Enclosure

cc: All Regional Directors
All Regional Counsel