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July 2, 1981

ATTORNEY GENERAL OPINION NO. 81-158

Roy P. Britton
State Bank Commissioner
Suite 600
818 Kansas Avenue
Topeka, Kansas 66612

Re: Contracts and Promises -- Interest and Charges -- Extension of Most Favored Lender Doctrine to State Banks

Synopsis: The "most favored lender" doctrine established under 12 U.S.C. §85 permits national banks to charge the maximum rate of interest permitted under state law to any competing lender. Section 521 of P.L. 96-221, the Depository Institutions Deregulatory and Monetary Control Act of 1980, accords most favored lender status to state-chartered, federally-insured banks. Thus, by virtue of the most favored lender doctrine and the express provisions of said section 521 (12 U.S.C. §1831d), state banks in Kansas may charge interest at a rate which is the greatest of either: (1) one percent over 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; (2) the rate specifically prescribed for state banks by the laws of Kansas; or (3) the highest rate available to lenders generally pursuant to the laws of Kansas.

Additionally, interest rates on agricultural and business loans of $1,000 or more have been preempted by federal legislation, and such rates are now prescribed by section 324 of P.L. 96-399. Cited herein: K.S.A. 1980 Supp. 16a-2-401, as amended by section 1 of 1981 House Bill No. 2578, L. 1980, ch. 76, §1, 12 U.S.C. §§85, 86a, 1831d, P.L. 96-221, §§501, 511, 512, 521, 522, 523, 525, P.L. 96-399, §324, 12 C.F.R. §7.7310.

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Dear Mr. Britton:

On your behalf, Mr. Carl Sandstrom, Assistant Bank Commissioner, has requested us to review an opinion of the Legal Division of the Federal Deposit Insurance Corporation (FDIC). In effect, that opinion concludes that the enactment by Congress of P.L. 96-221, the Depository Institutions Deregulatory and Monetary Control Act of 1980, and, specifically, section 521 of that Act, accord to federally-insured state banks "most favored lender status," thereby authorizing any such state bank to charge interest at a rate which is the greatest of either: (1) one percent over 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; (2) the highest rate available to lenders generally in the state where such bank is located; or (3) the rate specifically prescribed for such bank by laws of the state where it is located.

Section 521 of P.L. 96-221 (94 Stat. 161; 12 U.S.C. §1831d) provides in pertinent part:

> "In order to prevent discrimination against State-chartered insured banks, including insured savings banks and insured mutual 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."

The effective date of this section was set forth at section 525 of P.L. 96-221 ("Act"), which states:

> "The amendments made by sections 521 through 523 of this title shall apply only with respect to loans made in any State during the period beginning on April 1, 1980, and ending on the date, on or after April 1, 1980, on which such State adopts a law or certifies that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the amendments made by such sections to apply with respect to loans made in such State, except that such amendments shall apply to a loan made on or after the date such law is adopted or such certification is made if such loan is made pursuant to a commitment to make such loan which was entered into on or after April 1, 1980, and prior to the date on which such law is adopted or such certification is made."

At this point, the Kansas Legislature has taken no action in accordance with the foregoing provisions of section 525 to remove the State of Kansas from the operation of section 521, although we note that the 1980 Kansas Legislature acted to exempt the state from the operation of section 501(a)(1) of the Act. See L. 1980, ch. 76, §1. Said section 501(a)(1) preempts state law regarding the rates of interest which may be charged on loans, mortgages, credit sales or advances which are:

> "(A) secured by a first lien on residential real property, by a first lien on stock in a residential cooperative housing corporation where the loan, mortgage, or advance is used to finance the acquisition of such stock, or by a first lien on a residential manufactured home;
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> "(B) made after March 31, 1980; and
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> "(C) described in section 527(b) of the National Housing Act (12 U.S.C. 1735f-5(b), except . . . ."

Therefore, while the legislature chose to exempt the state from the provisions of P.L. 96-221 relating to interest rates on mortgages, it did not take such action with respect to sections 521 through 523 of the Act and, specifically, section 521, in question here. Thus, as of April 1, 1980, section 521 is the law of Kansas respecting interest rates on general loans made by state-chartered insured banks.

The FDIC's conclusion that the "most favored lender status" is accorded state-chartered, federally insured banks by section 521 is predicated on three factors: The literal construction of the language, the legislative history behind the section and the case law interpretation of the language in 12 U.S.C. §85.

In examining the first factor, the literal construction of the language, the FDIC's General Counsel correctly noted that the language of the section clearly states that its purpose is "to prevent discrimination against State-chartered insured banks . . . with respect to interest rates." Furthermore, the section sets forth two possible interest rates and authorizes the banks to charge whichever is the greater of the two. As noted from the provisions of section 521 quoted above, the alternative interest rates are (1) "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 (2) "the rate allowed by the laws of the State, territory, or district where the bank is located."

It is primarily from an interpretation of the language setting forth the second possible interest rate, "the rate allowed by the laws of the state," that the FDIC concluded most favored lender status is now accorded to insured state banks. This was based on the determination "that Congress intended that 'the rate allowed by state law' should be the highest rate allowed to any lender under state law." In support of this determination, the FDIC opinion relies upon Congressional intent, as evidenced by legislative history, and upon case law construction of similar language in 12 U.S.C. §85.

First, as to Congressional intent, the FDIC opinion states:

> "The legislative history supports this. The following comments were made during the House

> and Senate debates on H.R. 4986, the bill containing language which eventually became Section 27(a). 'Title V . . . contains a provision [Section 521] which provides parity, or competitive equality, between national banks and state chartered depository institutions on lending limits.' 126 Cong. Rec. S3170 (daily ed. Mar. 27, 1980) (remarks of Sen. Proxmire). '[Insured state banks will now be permitted] to charge 1 percent over the Federal Reserve discount rate - or the rate permitted by state law if that is higher.' Id. at S3177 (remarks of Sen. Bumpers). 'State chartered depository institutions are given the benefits of 12 U.S.C. 85.' Id. at S3170 (remarks of Sen. Proxmire)." (Emphasis added.)

Second, the FDIC opinion notes the similarity of the language used in section 521 to that used in 12 U.S.C. §85 under which the most favored lender doctrine has been formulated in regard to national banks.

We agree with the analysis of the most favored lender doctrine in the FDIC opinion, and at this point it should be noted that, in Attorney General Opinion No. 80-94, we analyzed and applied this doctrine in reaching the conclusion that it was unnecessary for national banks to become "licensed" in order to charge the interest rates authorized for licensed supervised lenders by K.S.A. 1980 Supp. 16a-2-40(2) (now amended by section 1 of 1981 House Bill No. 2578). Although we concur completely in the analysis of the most favored lender doctrine in that prior opinion, for the sake of clarity in our response to your request, we believe it appropriate here to reiterate much of what was said as to the validity of this doctrine in our earlier opinion.

The most favored lender doctrine is, for the most part, a judicial interpretation of 12 U.S.C. §85, which 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." (Emphasis added.)

Also of pertinence here is 12 C.F.R. §7.7310(a), which provides the interpretation of the Comptroller of the Currency as to the interest rate policy contemplated by the National Banking Act:

> "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." (Emphasis added.)

Section 30 of the National Banking Act (a nearly identical predecessor of 12 U.S.C. §85) was interpreted by the U.S. Supreme Court in Tiffany v. National Bank of Missouri, 18 Wall (85 U.S.) 409, 21 L.Ed. 862 (1873). The decision in Tiffany is credited with first establishing the most favored lender doctrine. In pronouncing this doctrine, the Court stated:

> "There are three provisions in section 30, each of them enabling. If no rate of interest is defined by state laws, seven per cent is allowed to be charged. If there is a rate of interest fixed by state laws for lenders generally, the banks are allowed to charge that rate, but no more; except that if state banks of issue are allowed to reserve more, the same privilege is allowed to national banking associations. Such, we think, is the fair construction of the act of Congress, entirely consistent with its words and with its spirit. It

> 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 . . . . It cannot be doubted, in view of the purpose of Congress in providing for the organization of national banking associations, that it was intended to give them a firm footing in the different states where they might be located. It was expected they would come into competition with state banks, and it was intended to give them at least equal advantages in such competition. In order to accomplish this they were empowered to reserve interest at the same rates, whatever those rates might be, which were allowed to similar state institutions. This was considered indispensable to protect them against possible unfriendly state legislation. Obviously, if state statutes should allow to their banks of issue a rate of interest greater than the ordinary rate allowed to natural persons, national banking associations could not compete with them, unless allowed the same. On the other hand, if such associations were restricted to the rates allowed by the statute of the state to banks which might be authorized by the state laws, unfriendly legislation might make their existence in the state impossible. A rate of interest might be prescribed so low that banking could not be carried on except at a certain loss. The only mode of guarding against such contingencies was that which, we think, Congress adopted. It was to allow to national associations the rate allowed by the state to natural persons generally, and a higher rate, if state banks of issue were authorized to charge a higher rate. This construction accords with the purpose of Congress, and carries it out. It accords with the spirit of all the legislation of Congress. National banks have been national favorites." 18 Wall at 411-413, 21 L.Ed. at 863, 864. (Emphasis added.)

Subsequently, the Supreme Court's position in Tiffany was reaffirmed in Daggs v. Phoenix National Bank, 177 U.S. 549, 44 L.Ed. 882 (1899), where the Court stated:

> "We said in Tiffany v. National Bank, 18 Wall. 409, 21 L.Ed. 862, that national banks were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the general government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the states, or to ruinous competition with state banks." 177 U.S. at 555, 44 L.Ed. at 884.

Further, with regard to the statutory provisions now embodied in 12 U.S.C. §85, the Court held:

> "The meaning of these provisions is unmistakable. A national bank may charge interest at the rate allowed by laws of the state or territory where it is located; and equality is carefully secured with local banks.
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> ". . . The intention of the national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks organized by it. Tiffany v. National Bank, 18 Wall. 409, 21 L.Ed. 862." 177 U.S. at 555, 44 L.Ed. at 885. (Emphasis added.)

In Northway Lanes v. Hackley Union Bank & Trust Co., 464 F.2d 855 (6th Cir. 1972), the Sixth Circuit Court of Appeals held that a Michigan national bank could legally charge closing costs of a real estate loan in addition to interest, since savings and loan associations in Michigan were permitted to make such additional charges, even though a state bank was not permitted to do so. In holding thus, the court discussed Title 12, United States Code, stating in part:

> "The legislative history of this statute indicates a Congressional intent to give national banks special competitive advantages over state banks, by permitting national banks to charge interest at the highest rate available to lenders generally in each respective state." (Emphasis added.) Id. at 861.

Continuing as to the specific question at issue in that case, the court held as follows:

> "Appellants contend that 12 U.S.C. §85 restricts the rate of interest national banks may charge to the rate established by state law for state 'banks'; that savings and loan associations are not 'banks'; and that national banks, accordingly, may not charge a borrower interest which a savings and loan association concededly could charge under Michigan law on the same type of loan. The legislative history of the act simply does not support this construction. . . . The legislative history of Section 85 therefore requires the conclusion that national banks may charge as much interest as savings and loan associations are allowed to charge on equivalent transactions by Michigan law." Id. at 862. (Emphasis added.)

Finally, the Court in Northway Lanes discussed 12 C.F.R. §7.7310, noting that the interpretations contained therein,

> "made by an office charged with the responsibility of promulgating reasonable regulations pursuant to the National Banking Act, and supported by the legislative history of the Act and by the Supreme Court's decision in Tiffany, supra, are entitled to deference by this Court. . . . The fact that savings and loan associations may be organized and operated in a manner different from banks generally does not, contrary to appellant's suggestions, alter the fact that such associations should be treated as 'competing state-chartered or licensed lending institution[s],' within the meaning of Ruling 7.7310, supra. The conclusion is inescapable that the National Bank Act accorded national banks the right to charge the interest rate afforded their state competitors whether the competitor was a state bank or other non-bank lender. See, Tiffany v. National Bank of Missouri, supra." Id. at 864. (Emphasis added.)

The holding in Northway Lanes and the decision in United Missouri Bank of Kansas City, N.A. v. Danforth, 394 F. Supp. 774 (W.D. Mo. 1975), were relied upon in holding that a

Nebraska national bank could legally charge, with respect to credit card transactions, rates allowed by Nebraska law to small loan companies. Fisher v. First Nat. Bank of Omaha, 548 F.2d 255 (1977). In reaching that conclusion, the Eighth Circuit Court of Appeals discussed the "most favored lender" doctrine developed by prior judicial interpretations of Congressional intent underlying the National Banking Act.

> "12 U.S.C. §85 was designed by Congress to place national banks on a plane of at least competitive equality with other lenders in the respective states, and, indeed, to give to national banks a possible advantage over state banks in the field of interest rates. Thus, a national bank is not limited to the interest rate that a state bank may charge with respect to a particular type of loan if another lender in the state is permitted to charge a higher rate of interest on the same type of loan. In that situation the national bank may charge the higher rate. This 'most favored lender' doctrine was recognized by the Supreme Court in Tiffany v. National Bank of Missouri, 18 Wall. (85 U.S.) 409, 21 L.Ed. 862 (1873), and it was discussed and applied by this court in First Nat'l Bank in Mena v. Nowlin, 509 F.2d 872 (8th Cir. 1975). The doctrine was also applied in Fisher v. First Nat'l Bank of Chicago, supra, and in Northway Lanes v. Hackley Union Bank & Trust Co., supra.
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> "As pointed out in Northway Lanes, supra at 864, the Comptroller of the Currency has considered for many years that §85 incorporates the 'most favored lender' doctrine, and that national banks may charge the maximum rate permitted by state law to any competing state chartered or licensed lending institutions, including institutions licensed by state law to make 'small loans.'" (Emphasis added.) Id. at 259, 260.

Therefore, it is clear that under the most favored lender doctrine, as it has been established in accordance with 12 U.S.C. §85, a bank accorded such status is authorized to charge the maximum rate of interest permitted under state law to any competing lender in the state. Furthermore, it

also is apparent that the bank making such loans is subject only to the provisions of state law relating to the determination of the interest rate for such loans. This latter conclusion finds support, as noted in the FDIC opinion, in the interpretation of 12 U.S.C. §85 issued by the Comptroller of Currency and set forth at 12 C.F.R. §7.7310(a), which we previously quoted herein.

As pointed out earlier, the language of 12 U.S.C. §85, upon which the doctrine of the most favored lender has become well established, is very similar to the language in section 521. Recognizing such fact, the FDIC opinion states:

> "By employing the same terminology in constructing . . . [§521] as was used in 12 U.S.C. 85, it is only logical to conclude that Congress intended those words to have the same meaning. In fact, this is the only interpretation consistent with the Congressional intent to provide parity for national and insured state banks. Since national banks have been accorded most favored lender status, the same must be accorded to insured state banks under . . . [§521] in order to prevent discrimination with respect to interest rates." (Emphasis added.)

Therefore, we believe that Congress, by using the phrase "the rate allowed by state law," intended that insured state banks be given the status of most favored lender and be allowed to charge the highest rate of interest allowed to any lender under state law. Thus, we agree with the analysis of the FDIC opinion and its conclusion that:

> "Since the legislative history of . . . [§521] as well as the plain meaning of its terms mandates a finding that it was the Congressional intent to provide parity between insured state banks and national banks with respect to interest rates, and since the language employed in . . . [§521] parallels that of 12 U.S.C. 85, which has accorded national banks most favored lender status, it is the Legal Division's position that . . . [§521] incorporates the most favored lender doctrine. Therefore, under this subsection insured state banks may charge interest at 1 percent over the discount rate, the highest rate allowed to any lender under state law or the rate specifically prescribed for state banks under state law, whichever of the three is greatest."

Finally, you have inquired specifically as to federal preemption of interest rates on agricultural and business loans. Section 511 of Title V of the Act relates to business and agricultural loans and provides, in pertinent part:

> "(a) If the applicable rate prescribed in this section exceeds the rate a person would be permitted to charge in the absence of this section, such person may in the case of a business or agricultural loan in the amount of $25,000 or more, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any such loan, interest at a rate of not more than 5 per centum in excess of the discount rate, including any surcharge thereon, on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the person is located."

This section was amended subsequently by section 324 of P.L. 96-399, so as to make it applicable to agricultural and business loans of $1,000 or more. The effective date and duration of the original section 511 are set forth in section 512 of the Act, which states:

> "The provisions of this part shall apply only with respect to business or agricultural loans in amounts of $25,000 [now $1,000] or more made in any State during the period beginning on April 1, 1980, and ending on the earlier of --
>
> (1) April 1, 1983; or
>
> (2) the date, on or after April 1, 1980, on which such State Adopts a law or certifies that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to loans made in such State,
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> except that such provisions shall apply to any loan made on or after such earlier date pursuant to a commitment to make such loan which was entered into on or after April 1, 1980, and prior to such earlier date."

As the legislature has not exempted the state from this section, it applies in Kansas. We agree with the analysis of the effect of section 512, as amended by P.L. 96-399, that is stated in the memorandum of January 12, 1981, from the Kansas Legislative Research Department to the Kansas Senate's Committee on Commercial and Financial Institutions:

> "The effect of P.L. 96-399 is to remove, until April 1, 1983, all agricultural loans in excess of $1,000 from interest rates established by the Kansas UCCC. Prior to October 8, 1980, loans in amounts of less than $25,000 were subject to the UCCC while loans in excess of $25,000 could be made under the formula of the discount rate plus 5 percent plus any applicable surcharge. The maximum rate of interest allowable at this time for agricultural loans in excess of $1,000 is 13 percent + 5 percent + 3 percent = 21 percent. It is our understanding that the term 'loans' includes 'credit sales' thereby making the federal interest rate applicable both to lenders and to sellers.
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> "The effect of P.L. 96-399 is to remove, until April 1, 1983, all business loans in excess of $1,000 from interest rates established by the UCCC, if they had been made subject to the UCCC by agreements, and by K.S.A. 1980 Supp. 16-207, the general usury statute. The maximum rate of interest currently allowable for business loans in excess of $1,000 is 21 percent."

Therefore, it is our opinion that interest rates on agricultural and business loans of $1,000 or more have been preempted by federal legislation, and such rates are now prescribed by section 324 of P.L. 96-399 (see 12 U.S.C. §86a).

Very truly yours,

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