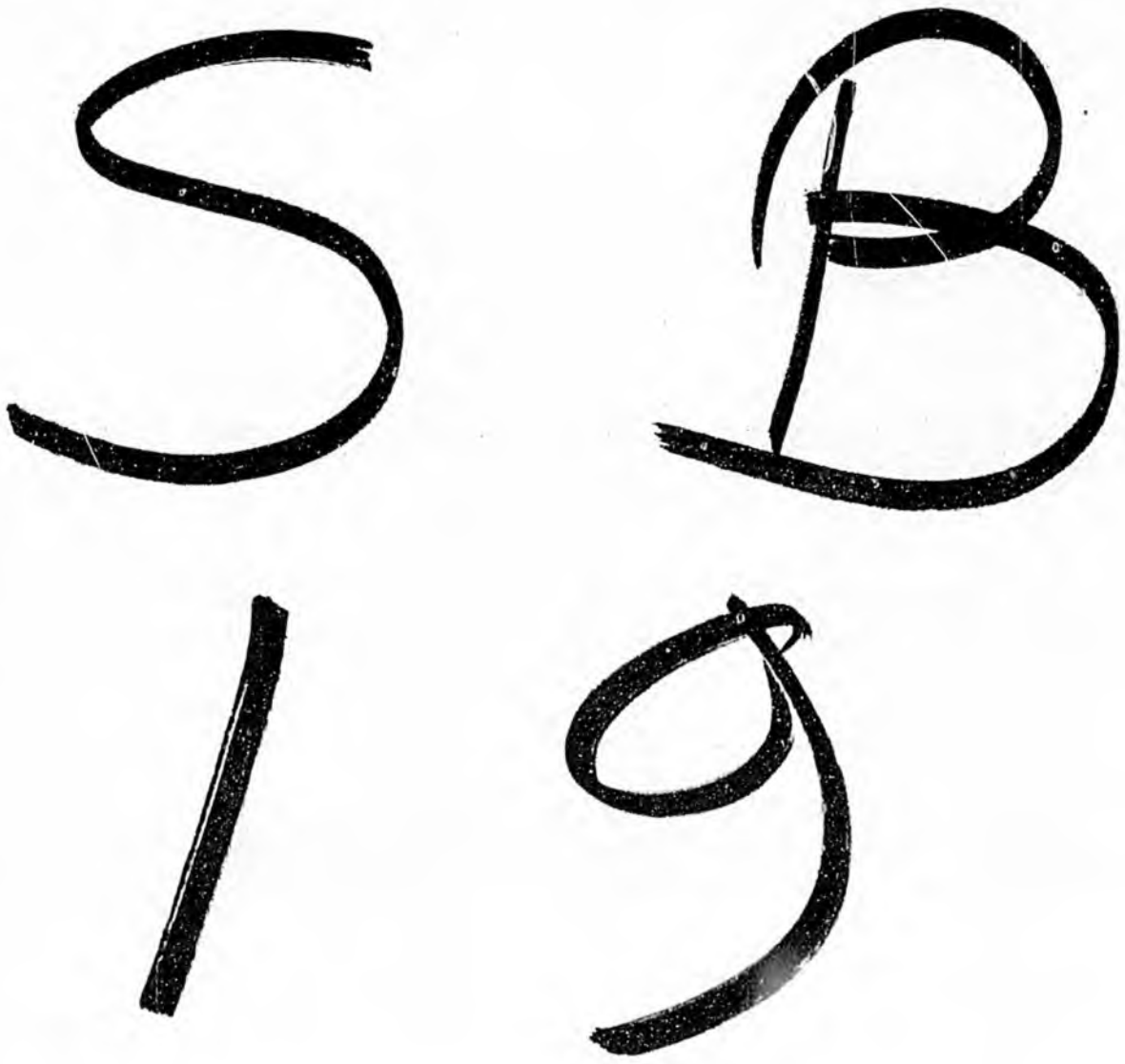
SB
19

COMMITTEE REPORT

HOUSE

2/26/81

FURTHER: FINANCE

(5)

Date: _____

Mr. Speaker:

The Committee on LABOR & COMMERCE has had SB 19am

"An Act relating to the legal rate of interest; and providing for an effective date."

under consideration and (a majority of the committee) (the committee) reports it back with the following recommendations:

[ ] do pass [ ] do not pass

[ ] do pass with attached amendments(s)

[✓] replace with CS for SB 19 am [X] same title [ ] new title

and recommends _____

[ ] AND attaches a "Letter of intent" [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the _____ Committee

MEMBERS SIGNING
DO PASS

Terry Gardner

Terry Martin

MEMBERS HAVING
OTHER RECOMMENDATIONS:

_____

CHAIRMAN

H 60 (Rev. 12/78)

Fact Sheet: SB 19 "An Act relating to the legal rate of interest."

Purpose: Amend the usury statute (1) to reduce the number of loans on which the interest rate is set by law rather than by free market forces; and (2) to adjust the procedure by which the legal rate of interest is set, by making it more timely.

At present, the usury statute applies to all loans originated in Alaska under $100,000. For those loans, the interest rate may not exceed five percentage points above the discount rate set by the Federal Reserve Bank of San Francisco (12th District) on the 25th day of the month preceeding the commencement of the present calendar quarter.

The following chart illustrates how this works:

QUARTER:	DATE RATE SET:	USURY RATE:
January, February, March	December 25, 1979: 12%	17%
April, May, June	March 25, 1980: 13%	18%
July, August, September	June 25, 1980: 11%	16%
October, November, December	September 25, 1980: 10%	15%
January, February, March	December 25, 1980: 13%	18%

If SB 19, as amended, were to become law, two things would happen:
(1) the usury ceiling would only apply to those loans under $25,000; i.e. those loans between $25,000 - $100,000 upon which the interest rate is presently set by law, would be made at whatever the lender and borrower decided was the market rate (essentially the cost of the money to the lender plus a reasonable profit); and
(2) the usury rate would be based on the present discount rate at the time the loan commitment is made.

Rationale: Although usury ceilings were originally designed to protect borrowers from unduly high interest rates, it is more likely that in today's market, they tend to deny financing to relatively riskier (or smaller) borrowers. For example, in November of 1980, several Alaska banks were lent money from the Department of Revenue in the form of certificates of deposit yielding from 15.25% - 16%. That was the cost of money to the banks. In November, banks were restricted by the usury ceiling from charging interest on loans of less than $100,000 to 15%. The question is, why would a bank make such a loan? The answer is, they wouldn't.

The reason for adjusting the procedure by which the usury ceiling is set, is simply that the present formula doesn't reflect present fluctuations in the capital market. For example, the legal rate of interest during the fourth quarter of 1980 was set at five points above the discount rate in effect on September 25, 1980, i.e. 15%. During the fourth quarter, however, the discount rate went up one percent on September 26, one percent on November 17, and one more percent on December 5. If SB 19, as amended, were to become law, lenders could have charged, say on December 5, 18%. As it was, they were limited by law, to charging 15%. Our guess is that consumer lending was down during this period.

Footnote: On March 31, 1980, Congress passed 96-221, "Depository Institutions Deregulation and Monetary Control Act", the most significant banking legislation pas ed since the Great Depression. One of the features of the bill allows the federal government to preempt state usury ceilings. Consequently, since April 1, 1980 the actual usury ceiling for business and agricultural loans over $25,000 has been five points above the discout rate at the time the loan commitment is made. There are provisions in the law for state override of the federal preemption. The state should take advantage of those provisions, and it is expected that the Senate Commerce Committee will be considering a further piece of legislation on this matter later this session.

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February 6, 1981

Please reply to: ANCHORAGE

Amendment #2

Senator Patrick Rodey
Pouch V
Juneau, AK 99811

RE: Senate Bill No. 19

Dear Senator Rodey:

I would like to take this opportunity to offer some suggestions for amendments to Senate Bill No. 19, "An act relating to the legal rate of interest; and providing for an effective date," introduced January 13, 1981 under your sponsorship and presently referred to the Senate Labor and Commerce Committee.

Due to apparent oversight by the legislature in prior sessions, an inequitable anachronism has been carried forward in the statutes of Alaska. AS 09.55.440(a) provides that the rate of judgment interest awarded under a declaration of taking proceeding will equal six per cent per year on the amount finally awarded which exceeds the amount paid into court under the declaration of taking. This provision was enacted in 1962, and has never been amended (ch. 101, § 13.21, SLA 1962 .

By way of background, a declaration of taking is often used by the State of Alaska in lieu of a complaint for condemnation and the correlative court order for possession. It provides for immediate possession in the State; otherwise the State must await the execution of an order giving it possession. The impact upon Alaskan landowners is the same regardless of whether their land is taken by a declaration of taking or a complaint for condemnation. However, a different rate of interest is paid to the landowner depending upon which method is used by the State. When a complaint seeking condemnation and an order for possession is used,

interest due the landowner (on amounts not deposited by the State) is governed by AS 09.55.330 which provides that the "lawful" rate of interest (AS 45.45.010) applies. This provision was enacted along with the provision applying to declarations of taking in 1962 (ch. 101, § 13.10, SLA 1962). Accordingly, it can be seen that in 1962 the legislature provided for the payment of interest at the rate of six per cent whether a declaration of taking or complaint seeking condemnation and an order for possession was used. However, in 1976 the statute setting the "lawful" rate of interest in Alaska [AS 45.45.010(a)] was amended to increase the rate of interest from six per cent to eight per cent. However, it would appear that no one has brought to the attention of the legislature the fact that interest under a declaration of taking condemnation remains at six per cent. Subsequent increases in the legal rate of interest have similarly failed to be reflected in AS 09.55.440(a).

It has been my unfortunate experience to witness the inequitable application of the six per cent interest statute to many landowners whose land is taken for public use. Surely, the procedural means by which possession is taken by the State should not dictate the rate of interest to be paid landowners on compensation which is delayed. However, attorneys in the Office of the Attorney General for the State of Alaska, while apparently recognizing the inequity of such differential treatment, are bound by AS 09.55.440(a).

The inequity in treatment was recently noted by the Supreme Court for the State of Alaska in State of Alaska v. Alaska Continental Development Corporation and Alaska General Properties, Inc., No. 2254, December 31, 1980 (emphasis added):

> We note the disparity between the interest rate specified in AS 09.55.440(a) and the other statutes mentioned. We also are concerned about the inequity in awarding a higher rate of interest on judgments obtained in one form of eminent domain proceeding than in another, as may result from the current provisions of AS 09.55.440(a) and AS 09.55.330. We strongly urge the legislature to consider amending what appears

to be a defect in the current statutory scheme. But we decline to repeal by judicial action the clear and unambiguous provision of an enactment of the legislature on the grounds that it must be an oversight.

Although the Alaska Supreme Court's recognition of the doctrine of separation of powers is admirable, landowners in the State of Alaska remain in need of an amendment to bring the rate of interest under a declaration of taking eminent domain proceeding in line with the other interest rate provisions in the Alaska statutes.

Since Senate Bill No. 19 will focus the legislature's attention on interest rate matters, it would seem an amendment or amendments may be attached to the bill which will remedy the inequitable situation described above. I would recommend for your consideration amendments to Senate Bill No. 19 along the following lines:

1. Insert a new Section 3--"AS 09.55.440(a) is amended to read:

   (a) Upon the filing of the declaration of taking and the deposit with the court of the amount of the estimated compensation stated in the declaration, title to the estate as specified in the declaration vests in the plaintiff, and that property is condemned and taken for the use of the plaintiff, and the right to just compensation for it vests in the persons entitled to it. The compensation shall be ascertained and awarded in the proceeding and established by judgment. The judgment shall include lawful interest [AT THE RATE OF SIX PERCENT PER YEAR] on the amount finally awarded which exceeds the amount paid into court under the declaration of taking. The interest runs from the date title vests to the date of payment of the judgment.

2. Renumber present Section 3 of Senate Bill No. 19 as Section 4.

I am enclosing for your convenience a copy of the relevant section from State of Alaska v. Alaska Continental Development Corporation and Alaska General Properties, Inc., No. 2254, December 31, 1980, and a version of Senate Bill No. 19 with the suggested amendments. Please feel free to contact me should you have any questions or need for further information with respect to this matter. I thank you for your time and consideration.

Very truly yours,

Steven S. Tervooren

SST/bs

Enclosure

cc: Senator Mulcahy, Chairman
Senate Labor and Commerce Committee

Mr. Chairman, I am John E. Malarkey, State Bank Commissioner for the State of Delaware, and Vice Chairman of the Federal Legislation Committee of the Conference of State Bank Supervisors on whose behalf I am appearing today. The Conference is the nationwide organization of state officials who serve as the primary chartering, examining and regulatory authorities for approximately 10,500 state-chartered commercial and mutual savings banks with total assets of approximately $500 billion.

My comments this morning will focus on the proposal to establish a Consumer Usury Study Commission. Although I am not aware of the full details of your proposal, the Conference is very concerned about federal preemption of states in the usury area and the need for a broader recognition of the efforts of states to establish greater flexibility in the lending area in order to meet the credit needs of their residents.

I note that your proposed Study Commission would be directed to the question of federal preemption of state usury ceilings and to possible alternatives to further federal preemption as well as to a number of other related areas. The Conference always has stressed its position that in setting usury ceilings, the states are in a better position to more responsively reflect the needs of their respective citizens than is the federal government. That is still our basic position, even though we have seen in recent months usury ceilings in a number of states become anachronistic, in part because of underlying conditions over which states had no direct

January 16, 1981

Mr. Roger D. Moore, President
SECURITY NATIONAL BANK
Pouch 7-777
Anchorage, Alaska 99510

Dear Mr. Moore:

RE: Interest rates applicable under Depository Institutions Deregulation and Monetary Control Act of 1980

I am enclosing a copy of an Attorney General's Opinion #J-66-452-81, dated January 2, 1981, for your information and comment. You will note that the text of this opinion is specifically directed to state-chartered credit unions. However, this division has had further contact with Ms. Leslie Ludtke, and she has informed me that this opinion is applicable to all insured despository institutions. 3672

This opinion effectively establishes three loan categories which are as follows:

1. Loans under $25,000 which the maximum interest rate allowable is 8 percentage points above the Federal Reserve Discount Rate as calculated on the first of the month proceeding the end of the calendar quarter.

2. Loans from $25,000 to $100,000 which the maximum interest rate allowable is 5 percentage points above the Federal Reserve Discount Rate as calculated on the 25th of the month proceeding the end of the calendar quarter.

3. Loans in excess of $100,000 which have negotiable interest rates.

If there are any questions, please contact this division at 465-2521.

Sincerely,

Willis F. Kirkpatrick
Director

WK/kkk5/3

Enclosure

MEMORANDUM State of Alaska

TO: Julius Brecht
Banking & Securities
Dept. of Commerce and Economic Development

DATE: January 2, 1981

FILE NO: J-66-452-81

TELEPHONE NO: 465-3675

FROM: WILSON L. CONDON
ATTORNEY GENERAL

SUBJECT: Depository Institutions Deregulation and Monetary Act of 1980.

By: Leslie J. Ludtke
Leslie J. Ludtke
Assistant Attorney General

You have requested this department's opinion regarding interest rates applicable to state chartered credit unions under the Depository Institutions Deregulation and Monetary Control Act of 1980. (Public Law 96-221) You have asked whether 12 U.S.C. §1757(5)(A)(vi) (1980 Deregulation and Monetary Control Act §310) applies to state chartered credit unions. We conclude that it does not.

Section 1757 of the federal Credit Union Act applies only to federally chartered credit unions. 12 U.S.C. § 1757 states that "A federal credit union . . . shall have power." The term "federal credit union" is defined under 12 U.S.C.. § 1752 as "a cooperative association organized in accordance with the provisions of this chapter . . ." Therefore, the provisions of 12 U.S.C. § 1757 do not apply to state chartered credit unions. 12 U.S.C. § 1757(5)(A)(vi) provides in part:

> (vi) the rate of interest may not exceed 15 per centum per annum on the unpaid balance inclusive of all finance charges, except that the Board may establish
> (I) after consultation with the appropriate committees of the Congress, the Department of Treasury, and the Federal financial institution regulatory agencies, an interest rate ceiling exceeding such 15 per centum per annum rate, for periods not to exceed 18 months, if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth;

Recently, the National Credit Union Administration (NCUA) Board raised the interest rates under this section to 21 percent. This rate supercedes the otherwise applicable rate established in 12 U.S.C. § 1785(g)(1) (1980 Deregulation and Monetary Control Act § 523). In relevant part, this section states:

> (g)(1) If the applicable rate prescribed in this subsection exceeds the rate an insured credit union would be permitted to charge in the absence of this subsection, such credit union may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this subsection, take, receive, reserve, and charge on any loan, 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 insured credit union is located or at the rate allowed by the laws of the State, territory, or district where such credit union is located, whichever may be greater.

Additionally § 528 of the 1980 Deregulation and Monetary Control Act provides that if one or more provision of the Act, or of any other law, applies to the same loan, the loan may be made at the highest applicable interest rate. The issue raised is therefore whether state chartered credit unions may charge 21 percent interest as authorized by 12 U.S.C. §1757(5)(A)(vi) or whether state chartered credit unions are limited to the rate set by 12 U.S.C. § 1785 when federally chartered credit unions are permitted to charge a higher rate under 12 U.S.C. § 1757(5)(A)(vi). Our conclusion that state chartered credit unions are not permitted to charge the higher rate established by the NCUA Board under 12 U.S.C. § 1757(5)(A)(vi) is based on three factors.

First, 12 U.S.C. § 1757 is not directly applicable to state chartered credit unions. This section sets out the powers which a federal credit union may exercise. The NCUA regulates the activities of federal credit unions by adopting rules to carry out this section. The activities of state chartered credit unions are not regulated by the NCUA and state chartered credit unions are not subject to the limitations nor are they granted the powers of federal credit unions under 12 U.S.C. § 1757. The conference report on the 1980 Deregulation and Monetary Control Act reinforces the conclusion that state chartered credit unions are not subject to 12 U.S.C. §1757.

The report states in part:

> The conferees adopted a provision which would allow federal credit unions to raise their loan rates up to an annual rate of 15 percent subject to rules issued by the National Credit Union Administration. The legislation would also permit the National Credit Union Administration to raise the loan ceiling above 15 percent for periods not to exceed 18 months, after consultation with appropriate Congressional committees, the Department of Treasury, and the other federal financial regulator agencies. 1980 Deregulation and Monetary Control Act. CCH Reports, paragraph 2036, pg. 211.

State chartered credit unions are, however, subject to regulation under 12 U.S.C. § 1785 which sets out the requirements governing federally insured credit unions. State chartered credit unions are federally insured. The Conference Report on 12 U.S.C. § 1785, 1980 Deregulation and Monetary Control Act § 523, states in part:

> State usury ce[illegible]gs on all loans made by Federally in[illegible]ed depository institutions (except national banks), and small business investment companies will be permanently preempted...

Because state chartered credit unions are federally insured depository institutions, the preemptive interest rate set out in 12 U.S.C. § 1785(g)(1) applies.

Secondly, 12 U.S.C. § 1785(g)(1) permits state chartered credit unions to charge 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 insured credit union is located or at the rate allowed by the laws of the State...where such union is located..." The phrase "at the rate allowed by the laws of the State" has been interpreted to mean at the highest rate allowed by the state to be charged by any lender for a particular type of loan.

For example, small loan licensees are permitted to charge a higher rate of interest under AS 06.20 for loans under $25,000 than other financial institutions may charge for these same loans.

Therefore, 12 U.S.C. § 1785(g)(1) would permit a federally insured state chartered credit union to charge the same rate as the small loan licensee for a loan under $25,000. 1/

The phrase "at the rate allowed by the laws of the State" is derived from the National Bank Act, 12 U.S.C. § 85, and is commonly referred to as the "most favored lender" doctrine. This doctrine originally was established to ensure parity between national banks and state chartered financial institutions. It allows a national bank, or in this instance a federally insured, state chartered credit union, to charge the same interest rate as any state chartered or licensed financial institution would be permitted to charge on a particular type of loan. 2/ The national bank, or state chartered credit institution, is granted parity by being permitted to charge the highest rate allowed for the state's most favored lender. The doctrine therefore focuses on the type of loan offered rather than establishing parity with the same type of financial institution. 12 U.S.C. § 1785(g)(i) incorporates this concept of most favored lender. It does not, however, establish a state chartered credit union's right to parity with a federally chartered credit union.

1/ The fact that a credit union is not licensed under AS 06.20 would not alter this result. See n.2, below.

2/ In Marquette Nat'l Bank v. First of Omaha Corp., 439 U.S. 299, 314 (1978) the Court stated that the "most favored lender" doctrine had "been interpreted for over a century to 'give advantages to National banks over their state competitors'." 12 C.F.R. § 7.7310 incorporates the "most favored lender doctrine", as expressed by case law, into the regulations of the Comptroller of the Currency. 12 C.F.R. § 7.7310 reads:

> §7.7310 Charging interest at rates permitted competing institutions . . .
>
> (a) 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.

The "most favored lender" doctrine refers to the highest permissible rate under state law. The authority to charge 21 percent on loans, under 12. u.s.c. § 1757(5)(A)(vi) is not a right granted by state law, but a right given by federal law. No law of Alaska specifically allows any financial institution to charge on a loan. Nor does state law incorporate any maximum rates set under federal law in establishing allowable state maximums. Therefore, although the concept of most favored lender is incorporated into 12 U.S.C. § 1785(g)(i), state chartered credit unions are not granted parity with federal credit unions. To construe the phrase "at the rate allowed by the laws of the State" to include the rate permitted by 12 U.S.C. 1757(5)(A)(vi) would constitute a misapplication of the "most favored lender" doctrine.

Third, Section 528 of the 1980 Deregulation and Monetary Control Act does not authorize state chartered credit unions to charge the rate set by the NCUA Board under 12 U.S.C. § 1757 (5)(A)(vi). This section reads:

> Sec. 528. In any case in which one or more provisions of, or amendments made by, this title, section 529 of the National Housing Act, or any other provision of law, including section 5197 of the Revised Statutes (12 U.S.C. 85) apply with respect to the same loan, mortgage, credit sale, or advance, such loan, mortgage, credit sale, or advance may be made at the highest applicable rate.

This section permits financial institutions to charge interest at the "highest applicable rate". Because we have concluded that 12 U.S.C. §1757(5)(A)(vi) does not apply to state chartered credit unions, Section 528 does not by its terms permit state chartered credit unions to charge a higher rate of interest than what would otherwise be permitted by 12 U.S.C. § 1785(g)(1). Section 528 authorizes the lender to charge the higher rate only when "one or more provisions. . .apply with respect to the same loan". 12 U.S.C. § 1757(5)(A)(vi) does not apply to loans made by state chartered credit unions.

It is our conclusion that state chartered credit unions are limited to charging the maximum interest rate established by 12 U.S.C. § 1785(g)(1). Although this provision incorporates the "most favored lender" doctrine, it does not grant state chartered credit unions most favored lender status with regard to interest rates set by federal law.

Additionally, it should be noted that the reference to state interest ceilings in 12 U.S.C. § 1785(g)(1) incorporates the relevant state law as to how interest may be computed and what charges are considered interest. 3/

LJL:wjp

3/ See First National Bank in Mena v. Nowlin, 509 F.2d 872 (8th Cir. 1975)