

**HB**

**447**

# FISCAL NOTE

STATE OF ALASKA  
2002 LEGISLATIVE SESSION

Fiscal Note Number: 1  
Bill Version: HB 447  
(H) Publish Date: 4/4/02

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: DCED  
Title Interest Rates on CFAB loans BRU Banking Securities & Corporations (115)  
Component Banking Securities & Corporations  
Sponsor Representative Mulder  
Requester House Labor & Commerce Component No. 1233

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2002) cost: 0.0  
Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

This legislation has no fiscal impact on the operations of this division.

Prepared by: Franklin T. Elder, Director Phone 907-465-2521  
Division: Banking Securities & Corporations Date/Time 3/27/02 5:29 PM  
Approved by: Deborah B. Sedwick, Commissioner Date 3/27/2002  
Agency: Department of Community & Economic Development

## Distributed By ED CRANE - CFAB

Like most states, Alaska has what is commonly called a "usury law"; a limitation on the rate of interest for certain types of loans – usually small loans. Alaska Statute 45.45.010 defines a small loan as one under \$25,000 and establishes a maximum annual fixed interest rate for such loans of 5.0 percent above the Twelfth Federal Reserve District discount rate (currently 2.0 percent).

"Usury" is a term whose meanings and connotations have changed over the years. There are a number of Biblical references, generally favorable, to usury. Over the ensuing thousands of years, though, societies and governments have determined and decreed that the term refers to interest rates which are unrealistic, unconscionable, or unlawful. Webster's New World Dictionary (Second College Edition) recognizes this change of meaning by defining the word as, "the act or practice of lending money at interest, now specifically, at a rate of interest that is excessive or unlawfully high."

The philosophies underlying usury laws are protective in nature. The Alaska Supreme Court, in a 1971 case, expressed that usury laws are designed to protect the necessitous borrower. They recognize that those whose needs and means are modest may often have the least flexibility, the fewest alternative sources of credit, and the fewest tools with which to bargain. The callous – but basically realistic – expression, "The poor pay more!" perhaps has no clearer application than may be found in the loan-sharking practices visited upon blue-collar communities, and even small businesses, in many parts of the United States. It is difficult to find arguments against these intents and philosophies; on the other hand, one may question the effects of the arbitrary manner in which the limits are set.

In Alaska, conventional lending institutions are not actually subject to the usury statute. A company whose principal business is the granting of small loans may organize under the Alaska Small Loans Act (AS 06.20), which effectively substitutes other, more liberal, interest rate limitations for that established by the usury statute. A few years ago, there were 18 to 20 such companies in Alaska; today there are apparently almost none. The vast majority of lending institutions – including commercial banks and credit unions – are exempt from state usury statutes by reason of the pre-emptive provisions of a Federal law, the Depository Institutions Deregulatory Act of 1980. There are a handful of other lenders, primarily private mortgage companies, who do not make loans under \$25,000 as a matter of

policy and who therefore are not affected by the usury statute. Of the two lenders who operate directly and primarily within CFAB's mandated market, one – Northwest Farm Credit Services – is subject to Federal laws which pre-empt Alaska's usury statute, while the other – the state's own Division of Investments – appears to enjoy a sovereignty exemption. Even those storefront enterprises that offer check-cashing services and "payday loans" to a clientele consisting largely of "necessitous borrowers" are beyond the reach of AS 45.45.010!

It appears that CFAB is the only corporate or institutional lender which is subject to Alaska's usury statute. Paradoxically, CFAB is also the only lender in Alaska which, by definition, cannot charge or collect "too much" interest!

CFAB is structured as, and operates as, a cooperative corporation as mandated by its governing statute. Its owners are its customers, and its customers are its owners; these customer-owners are known as "members." The interest rates charged to members are based on projections of CFAB's own borrowing costs and operating expenses. At the end of each fiscal year, excess income ("net margins," in cooperative parlance) is returned to members through a mechanism called a patronage refund. Over the past ten years, CFAB has returned over 16% of its gross interest income to members in this manner and has added another 2% of that gross income to the equity pool owned by the aggregate membership. Effectively, every borrowing member – large or small – is dealt with by CFAB on an "at cost" basis regardless of the interest rate paid.

Until very recently, CFAB's unique subjectivity to AS 45.45.010 has been viewed as a minor annoyance. The capital requirements of commercial fishing, as a generality, have not generated significant demands for small loans. As a rule – although absence of a firm policy permitted exceptions on a case-by-case basis – CFAB has discouraged small loans except to established members. Even those latter loans were limited to relatively short terms. Since CFAB's funding costs, and some operating expenses, are variable, CFAB could not bear the risk of establishing a large volume of low-yielding, fixed rate, loans in its portfolio with the potential for subsidization by other borrowing members during periods of higher or increasing interest rates or other costs. In addition, many of the origination and administration costs are essentially the same for a \$20,000 loan as for a \$120,000 loan.

At the present time, however, a convergence of factors has created a difficult scenario for CFAB and potential new members and, more importantly, a very real threat to the public purpose established for CFAB by the Alaska Legislature.

CFAB is the only private lender with the statutory authority to make a loan to purchase a limited entry permit and to secure that loan with an enforceable lien on the permit itself. Since CFAB serves only Alaska residents, this authority has proven a significant boon to those residents wishing to enter a fishery. On the other hand, when permits for many fisheries commanded transaction prices of \$150,000 to \$200,000 or so (a not uncommon range) a non-resident wishing to purchase a permit needed to possess some combination of cash and other lienable assets equal to or in excess of the purchase price in order to secure financing from some lender other than CFAB. This has been a significant, but probably incalculable, factor in maintaining a high level of resident participation in Alaska's fisheries.

In recent years, however, many fisheries' economics have changed. Today limited entry permits in some of Alaska's largest fisheries (in terms of participant numbers) are trading in a \$25,000-\$40,000 range. It has suddenly become much more feasible for the legendary "Seattle dentist" to simply obtain a low-cost home equity loan in order to buy an Alaska limited entry permit. Moreover, an increasing number of those residents who received "original issue" limited entry permits are reaching retirement age and seeking the opportunity to exit their respective fisheries. Several Seattle-based permit brokers, whose interests lie in facilitating transactions rather than in supporting public policy, have indicated an awareness of these factors. The immediate future appears to hold the potential for a drastic shift of permit ownership demographics!

At the same time, CFAB is effectively immobilized by a trio of irreconcilable factors: (1) A period of the lowest financial market rates – specifically, the discount rate of the Federal Reserve Bank of San Francisco – in its 21-year history; (2) Its subjectivity to AS 45.45.010; and (3) Its fiduciary duty to existing member-owners.

This is most certainly not a matter of intent by any party. Much legislative energy has been focused on CFAB over the years, not only through the originating efforts of

the 1978, 1979, and 1980 Legislatures, but in the many ensuing actions to address the unexpected or unintended anomalies which are probably inherent to the creation and existence of a truly one-of-a-kind instrument of public policy. While this appears to be one of the most threatening such anomalies to manifest itself, it is also probably one of the easiest to correct!

# BANK EXAMINER'S REPORT

Management/Administration

99999

Management and the board of directors/trustees are evaluated against all factors necessary to operate the institution in a safe and sound manner and their ability to identify, measure, monitor, and control the risks of the institution's activities. Consideration is given to the level and quality of oversight and support provided by management and the board; compliance with regulations and statutes; ability to plan for and respond to risks that may arise from changing business conditions or initiation of new products or services; accuracy, timeliness, and effectiveness of management information and risk monitoring systems; adequacy of and compliance with internal policies and controls; adequacy of audit and internal control systems; responsiveness to recommendations from auditors and supervisory authorities; reasonableness of compensation policies and avoidance of self-dealing; demonstrated understanding and willingness to serve the legitimate banking needs of the community; management depth and succession; the extent that management is affected by or susceptible to dominant influence or concentration of authority; and the overall performance of the institution and its risk profile.

CFAB continues to be operated in a sound manner. During the last legislative session, management was successful in amending current law to gain new lending authority for activities related to tourism or natural resource extraction. Since the passage of this legislation, management has originated seven loans totaling \$2,905M. Management intends to enter these new lending markets cautiously, in order to judge the effectiveness of all guidelines and policies that either have been or are in the process of being developed.

Over the next year, CFAB will undergo a substantial management change with the anticipated retirement of two essential personnel. The chief lender is retiring from the institution after almost 18 years with the institution. The president is also planning to retire after more than 17 years with the institution. These two individuals were primarily responsible for rebuilding CFAB during the mid-80's recession. It will be a significant event for the institution to find eligible candidates as replacements, but even more significant is the loss in institutional knowledge. Prior to his retirement, the president would like to resolve important issues that are obstacles to CFAB's continued operation. One of the issues relates to the state usury law under AS 45.45.010, which subjects CFAB to an interest rate cap. Because of deterioration in the fishing industry, CFAB has experienced a decrease in loan amounts, to the point where they may fall under \$25,000. Because the usury law limits the interest rate to five percentage points above the 12<sup>th</sup> Federal Reserve discount rate on loan amounts of \$25M or less, CFAB may find itself subject to this limitation. If the cap remains, it may lead to erosion of earnings for CFAB.

The board has also changed since the last examination. Two new members, Dan Farren and Susan Springer, were elected during the last annual meeting. The board minutes indicate the board members are active in a wide range of issues that affect the institution's operation.

New policies have been adopted since the last examination. These policies address appointment of management during emergencies, fixed asset expenditures, and a CoBank borrowing resolution. Insurance and bond coverage appear satisfactory.



## **Sponsor Statement for House Bill 447**

# **Com Fish & Agricultural Bank Interest Rate**

**“An Act relating to interest rates that may be charged on loans by the Commercial Fishing and Agriculture Bank.”**

House Bill 447 addresses an inequity in Alaska Statute 45.45 that inhibits the ability of the Alaska Commercial Fishing and Agriculture Bank (CFAB) to serve it's mandated purpose of granting loans for Alaskan small business enterprises.

Like most states, Alaska has what is commonly called a “usury law”; a limitation on the rate of interest for certain types of loans – usually small loans. AS45.45.010 defines a small loan as one under \$25,000 and establishes a maximum annual fixed interest rate for such loans of 5.0 percent above the Twelfth Federal Reserve District discount rate.

In Alaska, conventional lending institutions – including commercial banks and credit unions - are exempt from state statutes by reason of Federal pre-emptive provisions. Because of CFAB's organizational structure as a cooperative bank, it is the only Alaskan institutional lender subject to AS45.45 and by law, cannot charge “too much” interest. In reality, any interest collected in excess of its needs is credited back to its member-borrowers.

In the past, the commercial fishing community has not generated significant demands for small loans. However, because limited entry permits have recently begun trading in a \$20,000 - \$40,000 range, there is a much greater need for small loans. CFAB's subjectivity to the existing statute along with a period of the lowest financial market rates in over twenty years, renders it unable to make significant numbers of small loans to Alaskan residents, opening the potential for a drastic shift of permit ownership demographics.

The basic purpose of HB 447 is to ensure that CFAB is able to continue serving its Alaskan member-borrowers in an efficient manner and equitably compete with other lending institutions servicing their unique market.





# REPRESENTATIVE ELDON MULDER

DISTRICT 23 - MULDOON & FORT RICHARDSON

ALASKA STATE LEGISLATURE

HOUSE OF REPRESENTATIVES

"PROUD TO BE A MULDOONER"



## MEMORANDUM

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DATE: April 23, 2002

TO: Senator John Torgerson  
Chair: Senate Resources Committee

RE: HB447 relating to the interest rates that may be charged by  
The Commercial Fishing and Agriculture Bank (CFAB)

### MESSAGE:

During the public testimony at last Friday's hearing in Senate Resources Committee, there was a question raised by Mr. Jerry Weaver, representing Wells Fargo Bank and the Alaska Bankers Association.

The assertion was that the statement made in the Sponsor's Statement "*In Alaska, conventional lending institutions – including commercial banks and credit unions – are exempt from state statutes by reason of Federal pre-emptive provisions*", was false. Further, if HB447 were to become law, it would give an unfair lending advantage to CFAB over all the other banks in the state that were subject to the usury laws.

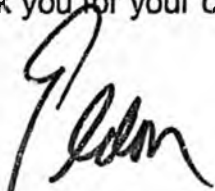
When a conclusive answer was not readily available, you set the bill aside and asked that we seek legal advice to resolve the question whether national or state licensed bank are exempt under federal law from state usury laws.

Attached is the legal review and opinion from Legal Services and a letter from the Banking and Securities Commission. Both documents conclude that the National Bank Act and "Most Favored Lender Doctrine" offer national and state banks exemptions to Alaska's usury laws - with the caveat that they *may* choose to follow them, if they wish to do so.

HB447 seeks to level the playing field for CFAB to participate in the lending arena by allowing the institution the same privilege of setting competitive interest rates that national and state banks have enjoyed.

I thank you for your judicious handling of the matter and offering an opportunity to clarify the assertion to the committee's satisfaction. I trust this will permit the Committee to resume consideration of HB447 and move it out to the next committee of referral at their earliest convenience.

Thank you for your consideration,

A handwritten signature in black ink, appearing to read "Eldon", written in a cursive style.

Representative Eldon Mulder  
Chair, House Finance Committee

# LEGAL SERVICES

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LEGISLATIVE AFFAIRS AGENCY  
STATE OF ALASKA

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State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

April 22, 2002

**SUBJECT:** HB 447 relating to the interest rates that may be charged by the Commercial Fishing and Agriculture Bank (Work Order No. 22-LS1537\A)

**TO:** Representative Eldon Mulder  
Attn: Dale

**FROM:**  Theresa L. Bannister  
Legislative Counsel

You have asked two questions relating to the bill described above. Please be aware that there are many issues that could be raised when interpreting the federal provisions discussed below, but due to time constraints only a broad general response is provided to you at this time.

1. Are national banks exempt under federal law from state usury laws? The National Bank Act appears to preempt state law concerning interest rates that can be charged by national banks.<sup>1</sup> In general, under 12 U.S.C. 85,<sup>2</sup> national banks can choose to use the

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<sup>1</sup> See Marquette National Bank of Minneapolis v. First National Bank of Omaha, 422 F.Supp. 1346, 1351-1352 (D.C.Minn. 1976).

<sup>2</sup> The relevant part of 12 U.S.C. 85 reads as follows:

**Sec. 85. Rate of interest on loans, discounts and purchases.** 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 title. 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

Representative Eldon Mulder  
April 22, 2002  
Page 2

interest rate that is established by federal law or they can choose to use the interest rate that is allowed to the most favored lender in the state where they are located.<sup>3</sup> This concept is called the "most favored lender doctrine."<sup>4</sup> National banks, therefore, appear to be exempt from state usury laws, although they may choose to follow them.

Notwithstanding the above general rule about selection of interest rate, there is in 12 U.S.C. 85 a provision that states that when a rate is not fixed by state law, the bank can use the rate provided in 12 U.S.C. 85. I have not reviewed this provision in any depth, so it is not clear to me how this would be applied and whether the national bank would be required to follow the federal interest rate in that case.

There may be limitations on the above general rule, but time has not allowed me to research these limitations. There are other provisions that preempt state interest rate law, but I have not had a chance to research how they relate to 12 U.S.C. 85. One, 12 U.S.C. 1735f-7a, appears to apply to mortgage lending rates, so it does not appear to be relevant to your current concerns. Another, 12 U.S.C. 86a,<sup>5</sup> also preempts state law<sup>6</sup> and allows a person making a business or agricultural loan to select the rate set in 12 U.S.C. 86a rather than state law.

2. Are state banks exempt under federal law from state usury law? With respect to state insured depository institutions, including banks, 12 U.S.C. 1831d<sup>7</sup> preempts state law

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advance, reckoning the days for which the note, bill, or other evidence of debt has to run....

<sup>3</sup> See Tiffany v. National Bank of Missouri, 18 Wall. 409 (1874); Northway Lane v. Hackley Union National Bank & Trust Co., 464 F.2d 855 (6th Cir. 1972); and Fisher v. First National Bank, 548 F.2d 255 (8th Cir. 1977).

<sup>4</sup> See Northway Lane v. Hackley Union National Bank & Trust Co., 464 F.2d 855 (6th Cir. 1972); and Fisher v. First National Bank, 548 F.2d 255 (8th Cir. 1977).

<sup>5</sup> 12 U.S.C. 86a(a) reads as follows:

(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 \$1,000 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.

<sup>6</sup> See First American Bank & Trust v. Windjammer Time Sharing Resort, Inc., 483 So.2d 732 (Fla App D4 1986).

<sup>7</sup> 12 U.S.C. 1831d(a) reads as follows:

(a) Interest rates. In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks,

Representative Eldon Mulder  
April 22, 2002  
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concerning interest rates. Under 12 U.S.C. 1831d, national banks can choose to use the interest rate that is established by federal law or they can choose to use the interest rate that is allowed to them in the state where they are located. This section accords to those state institutions the same "most favored lender doctrine" discussed in question no. 1 above.<sup>8</sup> Therefore, to the extent allowed by that statute, state insured banks are exempt from state usury laws, although they may choose to follow them.

As mentioned above, 12 U.S.C. 86a also preempts state law<sup>9</sup> and allows a person making a business or agricultural loan to select the rate set in 12 U.S.C. 86a rather than state law. I have not had time to research the coverage and application of this provision or how it relates to 12 U.S.C. 1831d.

If I may be of further assistance, please advise.

TLB:med  
02-401.med

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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.

<sup>8</sup> FDIC-81-3, February 2, 1981, interpreting 12 U.S.C. 1831d (General Counsel opinion).

<sup>9</sup> See First American Bank & Trust v. Windjammer Time Sharing Resort, Inc., 483 So.2d 732 (Fla App D4 1986).



Tony Knowles, Governor

**Department of Community  
and Economic Development**

**Division of Banking, Securities, and Corporations**

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April 22, 2002

Dale Anderson  
Legislative Aide  
Office of Representative Eldon Mulder  
Capitol Building, Room: 507  
Juneau, AK 99901-1182

Dear Mr. Anderson:

You have requested a statement of my understanding concerning the effects of the "most favored lender" doctrine, hereafter referred to as "the doctrine," and how it effects the rates banks can charge on loans. I must remind you that I am not an attorney, nor do I supervise interest rates in Alaska, except as those rates are specified in Title 6 of Alaska Statutes.

I was recently asked a similar question. To answer that question, I contacted the Federal Deposit Insurance Corporation (FDIC) and spoke with one of their staff attorneys. According to the FDIC attorney, the doctrine, found in Section 27 of the Federal Deposit Insurance Act, preempts state usury laws. It says that a financial institution, whose deposits are insured by the federal government, can charge the highest rate available to any state lender. In Alaska, the highest rates permissible for loans of less than \$25,000 is found in the Alaska Small Loans Act (AS 06.20) at AS 06.20.230.

Therefore, any bank, credit union, or savings and loan in Alaska, whether it is state or national/federal-chartered, could charge the rate specified in the Alaska Small Loans Act. The doctrine does not apply to the Alaska Commercial and Agricultural Bank (CFAB).

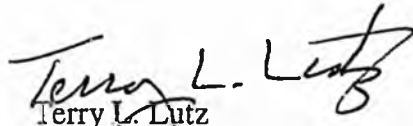
As I understand it, House Bill 447 would grant CFAB an exemption from AS 45.45.010-090, generally referred to as Alaska's usury law. To put CFAB on an equal footing with other Alaska lenders, then, it might make sense to give CFAB access to the rates provided for in the Alaska Small Loans Act for loans less than \$25,000, rather than simply to exempt CFAB from AS 45.45.010. If the legislature does that, it may also want to subject CFAB to certain other sections of the Alaska Small Loans Act (in particular AS 06.20.240-310), which small loan companies must follow and which offer added protections for borrowers.

Dale Anderson  
April 22, 2002

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I hope this has been responsive to your question. Please feel free to contact us if you have any further questions.

Sincerely,

  
Terry L. Lutz  
Financial Institution Examiner

cc: Terry Elder, Director



**John R. Beard**

Lawyer

First National Building  
425 G Street, Suite 630  
Anchorage, Alaska 99501  
(907)277-4531 FAX (907)277-9883

April 25, 2002

Jerry Weaver  
Alaska Bankers Association  
Wells Fargo Bank  
1500 W. Benson Blvd.  
Anchorage, Alaska 99503

David A. Lawer  
First National Bank Alaska  
P.O. Box 100720  
Anchorage, AK 99510-0720

Re: Applicability of AS 45.45.010(b) to business and agricultural loans by  
commercial banks

Gentlemen:

1. You have asked whether AS 45.45.010(b) applies to business and agricultural loans made by commercial banks in the state. The answer is "yes".

AS 45.45.010(b) applies by its terms to every loan ("contract or loan commitment"), without regard to the purpose of the loan or the identity of the lender or borrower. The only distinction it makes is the amount of the loan. The statute establishes "five percentage points above the annual rate charged by member banks for advances by the 12th Federal Reserve District on the day on which the contract or loan commitment is made" as the maximum interest that can be lawfully charged, but it exempts loans ("contracts or loan commitments") of more than \$25,000 principal from that limitation.

In all cases, of course, interest is fixed by the contract of the parties. AS 45.45.010(b) operates to *limit* the parties' freedom of contract in the case of loans of \$25,000 or less; the parties may of course agree to a lower interest rate. There is no limitation on the parties' freedom to contract for interest in the case of loans exceeding \$25,000.

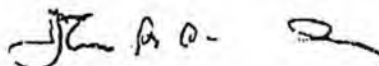
Page 2  
Jerry Weaver  
David A. Lawer  
April 25, 2002

2. You have also asked whether (a) the Federal Depository Institutions Regulatory and Monetary Control Act of 1980 (PL 96-221) or (b) any other federal law exempts business or agricultural loans by commercial banks from the limitations of Alaska law. The answer is "no".

(a) The 1980 federal statute established, for business and agricultural loans of \$1,000 or more, the same interest limitation as AS 45.45.010(b) places on all loans of \$25,000 or less (i.e., 5 percentage points above the applicable Federal Reserve Bank discount rate), and it preempted state laws that imposed lower limits. That statute, which was codified at 11 USC §86a, applied to all lenders (not just banks) and expired in 1983.

(b) Federal statutes that have not expired allow national banks (12 USC §85) and state banks whose deposits are federally insured (12 USC §1831d) to charge interest at a rate that is 1% above the applicable Federal Reserve discount rate if that rate is *higher than state law would allow*. Those statutes do not exempt banks from — indeed, they affirm that the banks are *subject to* — state usury laws that, like AS 45.45.010(b) (and, currently, AS 45.45.080), are more liberal in their allowance of interest.

Very truly yours,



John R. Beard

JRB/cmw



## Davis Wright Tremaine LLP

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April 29, 2002

### VIA TELEFAX

Mr. Ed Crane  
Alaska Commercial Fishing and  
Agriculture Bank  
2550 Denali Street, Suite 1201  
Anchorage, Alaska 99503

Dear Ed:

You asked me to comment on attorney John Beard's April 25, 2002 letter to Messrs. Weaver and Lawer of the Alaska Bankers Association, with particular emphasis on paragraph 2(b) of that letter.

Mr. Beard appears unaware that 12 U.S.C. § 85 and 12 U.S.C. § 1831(d) have long been interpreted to allow national banks and federally-insured state banks to charge the rate allowed to the "most favored lenders" under state law—the so-called "most favored lender doctrine." See Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299, 314 n.26 (1978) (applying 12 U.S.C. § 85); FDIC Advisory Opinion FDIC-81-3, February 2, 1981, Federal Banking Law Reports ¶ 81,006 (most favored lender status extends to federally-insured state banks). Under that doctrine, national banks and federally-insured state banks may charge the highest rate that may be charged by any institution under state law. The application of that doctrine in Alaska effectively exempts national banks and insured state banks from the usury limit contained in AS 45.45.010(b) by permitting such banks to charge the higher rates contained in Alaska's Small Loans Act (AS 06.20.010 – 06.20.920).

Very truly yours,

DAVIS WRIGHT TREMAINE LLP

  
Jon S. Dawson

# LEGAL SERVICES

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
State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

April 29, 2002

**SUBJECT:** HB 447 relating to interest rates (Work Order No. 22-LS1537A)

**TO:** Representative Eldon Mulder  
Attn: Dale

**FROM:**  Theresa L. Bannister  
Legislative Counsel

You have asked me to compare the April 25, 2002 letter ("letter") of John Beard with my memo ("memo") of April 22, 2002. There appears to be some confusion about the interplay of state and federal statutes in the banking area. It appears to me that at least some of the apparent confusion arises from terminology, so I will try to provide a general description of the situation that is not so tied to terminology.

Alaska has a general law on interest rates, which is AS 45.45.010. As stated in the letter, AS 45.45.010(b) ("subsection") establishes a maximum interest rate for loans up to \$25,000, but does not establish a maximum interest rate for loans over \$25,000. AS 45.45.010(h) provides that if the limitations on interest rates provided for in AS 45.45.010 are inconsistent with the provisions of any other statute covering maximum interest, service charges, or discount rates then the provisions of the other statute prevail. One example of an inconsistent provision is AS 06.20.230, which sets the maximum interest rate that may be charged by persons licensed to make small loans under AS 06.20.

However, when figuring out what interest rate is allowed for banks located or organized in this state, you must consider federal law, too. For banks organized under federal law ("national banks"), 12 U.S.C. 85 ("national bank provision") governs what interest rate they can charge. To this extent the national bank provision is considered to "preempt" our state law. This does not mean that state law does not exist or cannot be used. However, it does mean that the national bank provision will determine whether and how that state law may be used by national banks.

For banks that are organized under state law and insured by the FDIC, 12 U.S.C. 1831d ("federal insured bank provision") governs what interest rate these banks can charge. To this extent the federal insured bank provision "preempts" our state law. Once again, this does not mean that state law does not exist or cannot be used. However, it does mean that the national bank provision will determine whether and how that state law may be used by banks that are organized under state law and insured by the FDIC.

Representative Eldon Mulder  
April 29, 2002  
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Without going into detail on the specifics of the two federal laws, these two federal provisions essentially allow national banks and state FDIC-insured banks to select whether they want to use the interest rate identified in the federal law or the interest rate identified in the state law. Essentially they have the option to pick their interest rate. The national bank provision provides this right to national banks, and the federal insured bank provision provides a corresponding right to state FDIC-insured banks. This approach carries out the intent of the U.S. Congress to prevent national banks or state FDIC-insured banks from having an advantage over the other as to the interest rate they can charge. This approach is referred to as the "most favored lender" doctrine. Under this doctrine, national banks are allowed to charge interest at the rate stated in the federal law or at the highest rate permitted for any lender under state law. Under this doctrine, state FDIC-insured banks are allowed to charge interest at the rate identified in the federal law, at the highest rate allowed to any lender under state law, or at the rate specifically prescribed for state banks under state law.

I disagree with the conclusion in the letter that suggests that national banks and state FDIC-insured banks must use the rate identified in the federal law if it is higher than that identified in the state law. The federal laws appear to be permissive, not mandatory, on this point. Of course, a bank will probably choose the higher rate, but I do not believe that it must use that rate even if it is higher.

Although I used the term "exempt" in my earlier memo, the term is probably misleading in this situation because it suggests that state interest rate law never applies to a national bank or state FDIC-insured bank, and the relationship between the federal and state laws, as described above, is more complicated than that. While the federal provisions may not "exempt" banks from state interest rate law, the federal provisions do interact and "preempt" as described above.

Please note that 11 U.S.C. 86a does appear to have expired.

If I may be of further assistance, please advise.

TLB:med  
02-441.med

P.O. Box 100600

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May 2, 2002

Mr. Dale Anderson  
Office of Representative Eldon Mulder  
Alaska State Capitol Building  
Juneau, Alaska 99801  
VIA FACSIMILE: 907-465-3518

Re: HB 447-Relating to CFAB and Usury Interest Rates.

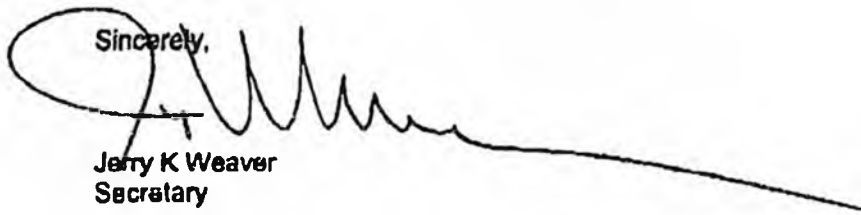
Dear Mr. Anderson:

This letter is to clarify the position of the Alaska Bankers Association on HB 447. As you noted in our telephone conversation interest rates, preemption and usury are complex legal subjects and the semantics can get confusing. Our objective in my testimony, April 19<sup>th</sup> was to correct the sponsor's statement that banks are exempt from state usury laws. As you and I discussed the Theresa L. Bannister memo to Representative Mulder dated April 29, 2002 is the clearest description I have seen describing the interaction of Alaska State Law and Federal Law.

In any case, the Alaska Bankers Association accepts the Ms. Bannister memo as a correct description of Alaska usury law and preemption. Further, the Alaska Bankers Association has not taken a position on HB 447 and does not plan to testify for or against the bill.

I hope our discussion and this letter helps clear the semantics on this issue.

Sincerely,



Jerry K Weaver  
Secretary