Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Business & Financial Services Committee

HB 1356

Brief Description: Restricting the interest rates of credit cards.

Sponsors: Representative Pearson.

Brief Summary of Bill

- Restricts the interest rate of credit cards offered by a financial institution to the state usury rate.

Hearing Date: 2/1/11

Staff: Jon Hedegard (786-7127).

Background:

Financial Institution Charters.
A charter determines the "primary" regulator of a financial institution and may impact the powers of the financial institution. A financial institution may choose to be chartered by the federal government or the state. It also may choose to change charters from one regulator to the other.

National Bank Regulations.
A "national bank" is a bank that is federally chartered by the Office of the Comptroller of Currency (OCC) under the National Bank Act (NBA). Until 1978, national banks followed the usury laws of the states where they were physically located. If they issued a credit card to a person in Washington, they would charge an interest rate up to Washington's usury rate. In 1978 the United States Supreme Court (Supreme Court) held that NBA meant that a national bank could "export" the usury rate allowed from its home state to another state if the loan is made in the home state. This changed the way the "location" was interpreted by lenders, regulators, and courts. A court would look at a host of factors to determine where a loan is made including where a loan was approved, where credit was extended, and where the funds are disbursed. The location where the borrower resided was a factor but not likely to be as important as the location of the lender's operations. For example, a national bank with credit card operations based in

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California who issued a credit card to a Washingtonian would probably be able to charge the Washington resident interest up to the usury rate in Washington or California whichever was higher. The interpretation of the NBA by courts lead the Office of the OCC to conclude that a national bank may charge "the most favored lender rates permitted by the state and may charge the permissible interest rates irrespective of the state of residence of the borrower."

Over time, the OCC adopted a number of rules purporting to preempt state authority over a number of areas related to banking. This subject of state preemption in the area of financial regulation has been before the United States Supreme Court a number of times in recent years. In 2010 federal financial legislation (House Resolution 4173 or the Dodd-Frank Wall Street Reform and Consumer Protection Act) included provisions that state the intention of the Congress to "roll back" certain Supreme Court decisions limiting a state's ability to regulate national banks and precluding broad preemption. Generally, state consumer financial laws are preempted only if:

- the application of the state consumer financial law would have a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that state;
- in accordance with the legal standard for preemption in the decision of the Supreme Court in *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al*., 517 U.S. 25 (1996), the state consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law; or
- the law is preempted by a provision of federal law other than Title 12 of the United States Code.

However, the legislation specifically stated that it was not intended to alter or affect the authority of a national bank regarding, "the charging of interest by a national bank at the rate allowed by the laws of the State, territory, or district where the bank is located, including with respect to the meaning of 'interest' under such provision."

State Bank Regulations.

A state bank is a bank chartered by this state. The state can impose any limits of interest on a bank charted by the state. In response to the evolution of national bank lending practices, the state eventually passed "parity" legislation allowing state banks to charge what a national bank is allowed to charge.

Other Financial Institutions.

An analogous evolution of authority regarding other federally regulated financial institutions also occurred with federal regulators purporting to preempt state restrictions on federally chartered institutions. The state adopted similar "parity" provisions for state chartered institutions. It should be noted that federal regulations also impact lending by federal credit unions and their allowable rate of interest.

State Usury Rate.

State law prohibits interest from exceeding the higher of:

- 12 percent per annum; or

- 4 percentage points above the equivalent coupon issue yield (as published by the Board of Governors of the Federal Reserve System) of the average bill rate for 26 week treasury bills, as determined at the first bill market auction conducted during the calendar month immediately preceding the later of: (1) the establishment of the interest rate by written agreement of the parties to the contract, or (2) any adjustment in the interest rate in the case of a written agreement permitting an adjustment in the interest rate.

There are a number of exceptions to the usury rate.

Summary of Bill:

"Financial institution" is defined as state and national banks and trust companies, state and federal savings banks, state and federal savings and loan associations, and state and federal credit unions.

A financial institution may not charge an interest rate in connection with the credit card that is in excess of the maximum rate allowed under RCW 19.52.020.

If any provision of the act or its application to any person or circumstance is held to be invalid, the entire act is invalid.

Appropriation: None.

Fiscal Note: Requested on January 31, 2011.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.