

September 4, 1997

Philip L. Carson, Esq.
Miller Carson Boxberger & Murphy LLP
One Summit Square
Suite 1400
Fort Wayne, IN 44802-3173

Re: Application of State Consumer Lending Laws to Federal Credit Unions
Your Letter to Greg Troutner, Professional Federal Credit Union, dated December 19, 1996.

Dear Mr. Carson:

NCUA's Region IV Office requested that the Office of General Counsel review the legal opinion you provided in the above-referenced letter. Professional Federal Credit Union (FCU) requested an opinion on whether the FCU is subject to the provision of the Indiana Uniform Consumer Credit Code (UCCC) that permits consumers to refinance balloon payment loans on the same terms and conditions as the original loan at maturity. IND. CODE ANN. §24-4.5-2-405 (Burns 1996).

You contend that federal law and regulation do not preempt the Indiana state law provision referenced above. You state at page two of your letter:

[I]n order for preemption to prevail, there must be a clear conflict between the federal law and the state law, or a clear declaration in the federal law that all state laws on the subject are preempted, or the issue involved must relate to a subject in which there is a dominant federal interest in controlling the subject.

While we do not disagree with your general statement of the criteria considered in a federal preemption analysis, we disagree with your conclusion that FCUs in Indiana are subject to the above-referenced Indiana UCCC provision. You state these criteria in the disjunctive and, thus, according to your view, if any one of these criterion are present, federal law will be deemed to preempt state law. It is NCUA's position that all these criteria are present in the issue at hand.

Some additional background regarding federal preemption is useful to our discussion of this issue. Federal preemption of state laws stems from the supremacy clause, U.S. CONST., art. V, cl. 2, which provides that the laws of the United States shall be the supreme law of the land, notwithstanding any state laws to the contrary. Preemption may be express, as when specified in a statute, *Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 152-153 (1982), or it may be implied by the nature of federal legislation and the subject matter, even absent a declaration of preemptive intent. *Meyers v. Beverly Hills Federal Savings and Loan Ass'n*, 499 F.2d 1145, 1146 (9th Cir. 1974). Where Congress' preemptive intent is not expressly stated, it may be inferred on either of two bases. First, a state statute may conflict with federal law. *Fidelity Federal*, 458 U.S. at 152-153. Second, "the scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room" for state action in the same area. *Id.*; *Conference of Federal Savings and Loan Assn's v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921. Where Congress chooses to act, it may take over the entire field or only a portion thereof. *National State Bank, Elizabeth, N.J. v. Long*, 630 F.2d 981, 985 (3d Cir. 1980). While federal preemption of state law may be implied, it is not to be assumed, and federal legislation will only preempt a field traditionally within a state's police power if that is the clear intent of Congress. *National State Bank*, 630 F.2d at 985.

The Federal Credit Union Act (the Act) preempts state law regarding rates, terms of repayment and other conditions of FCU loans and lines of credit. In pertinent part, the Act states:

A Federal credit union . . . shall have power --

. . . .

(5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members in accordance with the following:

(A) Loans to members shall be made in conformity with criteria established by the board of directors

12 U.S.C. §1757(5). Federal law controls any terms and conditions related to loan maturities and any terms and conditions not in conformance with criteria established by each FCU's board of directors. Other provisions of the Act provide additional support for preemption. With regard to the duties of an FCU's board of directors, the Act provides:

Among other things, the board of directors shall --

. . . .

(8) subject to any limitations of this subchapter, determine the interest rates on loans, the security, and the maximum amount which may be loaned and provided in lines of credit;

. . . .

(20) establish lending policies

12 U.S.C. §1761b(8), (20). What distinguishes a *balloon* note from other types of loans is the term or maturity of the loan, and, as noted above, the Act expressly preempts state law in that respect.

A clear conflict exists between NCUA's lending regulation, which is federal law, and the Indiana UCCC provision regarding balloon loan refinancing. Indiana law gives consumers the right to refinance a balloon note without penalty on the original terms of the note. IND. CODE ANN. §24-4.5-2-405. Federal law allows an FCU board of directors to determine balloon loan refinancing terms and conditions.

Under its broad authority to prescribe implementing regulations, the NCUA Board issued the lending regulation at issue. 12 U.S.C. §1766(a); 12 C.F.R. §701.21. The preemption sections of the lending regulation were properly issued with the notice and comment required by the Administrative Procedures Act (APA) in 1984. 49 Fed. Reg. 30683 (August 1, 1984). In the regulation, the Board states its authority to regulate the rates, terms of repayment and other conditions of FCU loans and lines of credit, and its intention to preempt any state law purporting to limit or affect these issues. 12 C.F.R. §701.21(b)(1). Included in the list of terms controlled by federal law are "rates of interest and amounts of finance charges" and "the terms of repayment, including . . . balloon payments." 12 C.F.R. §701.21(b)(1)(i)(A), (ii)(C). The NCUA's regulation, which is a properly promulgated regulation under the APA and the Act, conflicts with and, therefore, preempts state law.

There is ample support for the conclusion that a dominant federal interest exists to control and regulate FCU lending. FCUs are instrumentalities of the federal government, chartered under the authority of federal statute. 12 U.S.C. §1754. Upon approval, an FCU exists as a corporation, "vested with all the powers and charged with all the liabilities conferred and imposed by . . . [Title I of the FCU Act] upon corporations organized hereunder." Similarly, the Board has sole authority to suspend or revoke an FCU's charter and to liquidate it. 12 U.S.C. §§1766(b), 1782(f), 1787. Generally, the Board has rulemaking authority governing an FCU's creation, express and incidental powers, and operations. 12 U.S.C. §1766(a). Our view is that

Congress, in the Act, contemplated a pervasive federal system of chartering, supervision, examination, and regulation of FCUs.

In support of your position, you place substantial emphasis on the lack of any reported case law upholding NCUA's preemption regarding loan terms and conditions, with the exception of certain state court cases of which you are aware upholding NCUA's preemption of state laws governing interest rates. Your reliance upon the *absence* of case law is misplaced. In our view, the absence of case law on this particular matter offers no weight to your contentions. For that matter, the absence of case law, if of any legal significance, indicates only that there has been no successful challenge to NCUA's position regarding preemption in this area. Regarding relevant case law, we suggest you review a recent Supreme Court decision addressing the deference to which agency interpretation is entitled. In *Smiley v. Citibank*, 517 U.S. ___, 135 L.Ed.2d 25 (1996), the Supreme Court upheld a regulation adopted by the Comptroller of the Currency (OCC) that permitted national banks to charge interest at the rate permitted by the state where a bank is located, the effect of which was to preempt the state law where the plaintiff resided. The Supreme Court held that the OCC regulation is entitled to substantial deference and is a reasonable interpretation of the National Bank Act.

It is our understanding that the legal position you have taken on this issue would severely limit the asset liability management policies for an FCU. We request that you reconsider your legal opinion in light of the discussion contained in this letter and suggest that you issue a revised opinion consistent with NCUA's rule and interpretations of the Act

Sincerely,

Sheila A. Albin
Associate General Counsel

GC/MSG:sg
SSIC 3000
97-0537

cc: Region IV
Greg Troutner, Professional FCU