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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

August 4, 2004

**Interpretive Letter #1004**  
**August 2004**  
**12 USC 85**

Subject: Prepayment fees

Dear [            ],

This is in response to your letter seeking confirmation that a national bank located in Michigan may charge prepayment fees consistent with a state parity statute that applies to loan-related charges imposed by state banks and which section 85 incorporates and applies to national banks.<sup>1</sup>

Section 85 allows a national bank to charge on any loan or other evidence of debt the rate of interest fixed by state laws for lenders generally, or a greater rate if permitted by state law for state banks.<sup>2</sup> This “most favored lender” status permits a national bank to contract with borrowers in any state for interest at the maximum rate permitted by the laws of the state in which the national bank is located. “Interest” for purposes of section 85 has been defined by OCC regulation to include “any payment compensating a creditor or prospective creditor for an extension of credit, making available a line of credit, or any default or breach by a borrower of a condition upon which credit was granted.”<sup>3</sup> Under this definition, the OCC has determined that prepayment fees are interest for purposes of section 85.<sup>4</sup>

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<sup>1</sup> [ **Bank** ] has its main office in [            ] and branches in several states including Michigan. Consequently, under certain circumstances, [ **Bank** ] may impose interest in accordance with section 85 and applicable Michigan law incorporated into section 85. *See* OCC Interpretive Letter No. 822, February 17, 1998, *reprinted in* [1997-98 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-265.

<sup>2</sup> *Tiffany v. National Bank of Missouri*, 85 U.S. 409 (1885). This “most favored lender” doctrine is incorporated into the OCC’s regulations that implement section 85. *See* 12 C.F.R. 7.4001(b).

<sup>3</sup> 12 C.F.R. 7.4001(a).

<sup>4</sup> *See* OCC Interpretive Letter 744, August 21, 1996, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-109. Federal law and regulations, however, provide additional flexibility and authority for national banks to impose prepayment fees, a specific type of interest charge, with respect to adjustable-rate mortgages (ARM loans), a specific type of loan. As pointed out in footnote 2 of Interpretive Letter 744, the OCC’s ARM regulation was adopted under the authority of 12 U.S.C. 371, which authorizes national banks to make real estate loans subject to “restrictions and requirements that the OCC may prescribe by regulation or order.” The statute in its current form was adopted by Congress for the purpose of providing “national banks with the ability to engage in more creative and flexible financing.” Pursuant to this statute, the OCC’s ARM regulation specifically provides, with certain limited exceptions, that “a national bank offering or purchasing ARM loans may impose fees for prepayment notwithstanding any State law limitations to the contrary.” 12 C.F.R. 34.23; Interpretive Letter by Eric Thompson,

In your request, you cite several Michigan statutes that impose limitations on prepayment fees.<sup>5</sup> However, you also cite a provision of Michigan law that provides:

A bank may collect interest and charges on loans and extensions of credit as permitted by the laws of this state or of the United States to any person.<sup>6</sup>

You then cite regulations of the Office of Thrift Supervision (“OTS”) that state that federal savings associations may impose loan-related fees, including prepayment fees, without regard to state laws that impose limitations on these fees.<sup>7</sup> As a result, you seek confirmation of your analysis that national banks, pursuant to 12 U.S.C. 85, may impose prepayment fees to the same extent that Michigan banks may impose prepayment fees based on the state law parity provision which, read literally, incorporates any authority provided to federal savings associations under OTS regulations to assess loan-related fees notwithstanding any state law limitations.

The cited OTS regulations assert that any state limitations that purport to regulate loan-related fees, including prepayment fees, do not apply to federal savings associations.<sup>8</sup> Thus, it could follow that as a result of Michigan’s parity provision applicable to “interest and charges on loans,” state banks, likewise, could impose prepayment fees, notwithstanding restrictions otherwise found in Michigan law, to the same extent that federal savings associations may impose prepayment fees notwithstanding Michigan law. If Michigan authorities interpret the parity provision to reach this result with respect to state banks, then we would we agree that by

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Director, Bank Activities and Structure, to Greg Pulles, General Counsel, TCF Financial Corporation (November 4, 1999) (unpublished). This regulation, which was originally adopted in 1981 and which then included a limited preemption of state restrictions on prepayment fees, was upheld by the Court of Appeals for the District of Columbia Circuit in 1983 as a valid exercise of the OCC’s authority under section 371. *Conference of State Bank Supervisors v. Conover*, 710 F. 2d 878 (D.C. Cir.1983).

<sup>5</sup> For instance, you cite Mich. Comp. Laws 438.31c(2)(c) which provides, with certain exceptions, that lenders making loans primarily secured by a first lien on a single family dwelling may not charge a prepayment fee or penalty above 1% of the amount of any prepayment made within three years of the date of loan and, thereafter, may impose no prepayment fee.

<sup>6</sup> Mich. Comp. Laws 487.14201(1)(2001 & Supp. 2004). This memorandum refers to this provision of the Michigan code as “the parity provision.” We note that for purposes of the parity provision, “person” is defined as “any individual, partnership, corporation, limited liability company, governmental entity, or any other legal entity.” *Id.* at 487.11202(r).

<sup>7</sup> 12 C.F.R. 560.2(b)(5).

<sup>8</sup> *Id.*

operation of section 85, national banks also would be able to impose prepayment fees notwithstanding restrictions otherwise found in state law.<sup>9</sup>

Sincerely,

**signed**

Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel

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<sup>9</sup> In response to your inquiry, we also note that this determination applies to the same extent that Michigan banks can impose prepayment fees under the parity provision notwithstanding the lien priority of the mortgage, whether the mortgage contains a fixed or adjustable rate (except that prepayment fees on ARM loans may be assessed in accordance with 12 C.F.R. 34.23), or whether the note is a closed-end or open-end note.