

February 11, 2005

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100 Carretera 165, Suite 605  
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Re: Preemption of the Puerto Rico Retail Installment Sales  
and Financing Companies Act.

Dear Mr. Sosa Llorens:

You have asked if the Puerto Rico Retail Installment Sales and Financing Companies Act (RISFCA), which addresses consumer lending and finance practices by retailers and lenders, applies to federal credit unions (FCUs). Our opinion is that federal law preempts RISFCA to the extent it purports to limit or affect the rates, finance charges, terms of repayment and other conditions of loans and lines of credit that FCUs offer to their members.

RISFCA is primarily a consumer protection statute regulating finance companies and requiring retailers that provide financing to their customers to make certain disclosures and prohibiting or restricting certain terms and conditions in consumer credit transactions. 10 P.R. Laws Ann. §§731 – 793 (2002). You provided an English translation of RISFCA and we have discussed with you your understanding of the scope of this law. In addition, you provided a copy of RISFCA's implementing regulations in Spanish but, as no English version is available, we have not included an analysis of them in our review of the issue you present. Based on our discussion with you, we do not think a review of the regulations would change our conclusion regarding the preemption issue we have considered.

While RISFCA, by its own terms, does not appear to be directly applicable to FCUs, our understanding from our discussion with you is that Puerto Rico's Office of the Commissioner of Financial Institutions (OCFI) has informed you informally that FCUs are subject to certain provisions. RISFCA defines finance companies to include businesses that purchase retail installment sales contracts and credit card issuers that are not authorized under any specific law to engage in the credit card business. 10 P.R. Laws Ann. §§731(15) (2002). We note that FCUs are expressly authorized by our regulations to issue credit cards. 12 C.F.R. §701.21(a). Regarding retail installment sales issues, it would have no direct applicability to FCUs since credit unions are not sellers of consumer goods. This would include those sections of the RISFCA, referenced in your

letter, relating to insurance and events of default. 10 P.R. Laws Ann. §§744, 749(b) (2002). Our understanding from you is that OCFI's position is that the provisions of RISFCA addressing permissible contract provisions apply to FCUs.

NCUA's position regarding preemption of state law in certain areas of lending, as stated in its lending regulation, derives from the regulatory authority granted to the NCUA Board by the Federal Credit Union Act (Act). 12 U.S.C. §§1751 *et seq*; 12 C.F.R §701.21. Our view is that the NCUA's lending regulation, which states it applies to the preemption of state law, applies as well to the preemption of the local laws of Puerto Rico. The Act expressly permits an FCU to offer loans and lines of credit to its members, 12 U.S.C. §107(5), and NCUA's lending regulation preempts any state law that would limit or affect lending rates, finance charges, repayment terms or other lending conditions of FCU loans and lines of credit to members.<sup>1</sup> 12 C.F.R. §701.21(b).

You have indicated that OCFI has informally advised you that financial institutions operating in Puerto Rico may not use an open end credit agreement to finance a consumer's purchase of a motor vehicle. While we find no express language in RISFCA establishing this prohibition, our view is that NCUA's lending regulation preempts this type of restriction in local law whether expressly stated in statute or regulation or a matter of local regulatory interpretation. Specifically, NCUA's lending regulation preempts state or local law that purports to limit or affect: the terms of repayment, including the maturity of loans and lines of credit; the amount, uniformity, and frequency of payment; and the purpose of the loan or line of credit. 12 C.F.R. §701.21(b)(1)(ii)(A)-(B), and (iii)(B).

While FCUs are authorized to offer revolving, open-end credit to their members, we note it is unusual to do so in the context of automobile financing, where the value of the collateral declines substantially with the passage of time. An FCU electing to provide this type of financing must be alert to the inherent safety and soundness considerations, and we suggest that FCUs considering this type of

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<sup>1</sup> NCUA's lending regulation preempts:

[A]ny state law purporting to limit or affect:

(i)(A) rates of interest and amounts of finance charges . . .

(ii) terms of repayment, including:

(A) the maturity of loans and lines of credit;

(B) the amount, uniformity, and frequency of payments, including the accrual of interest if payments are insufficient to pay all interest due;

(C) balloon payments; and

(D) prepayment limit s;

(iii) conditions related to:

(A) the amount of the loan or line of credit;

(B) the purpose of the loan or line of credit;

(C) the type or amount of security . . .

(D) eligible borrowers; and

(E) the imposition and enforcement of liens on the shares of borrowers and accommodation parties.

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lending may want to consult with their NCUA examiner before launching this type of lending program.

While the Act and NCUA regulations preempt much of the field of federal credit union regulation, NCUA's lending regulation identifies specific areas of state or local law that are not preempted. 12 C.F.R. §701.21(b)(2). Further, the Office of General Counsel has recognized in legal opinions the authority of states to regulate various aspects of federal credit union operations involving registration and certain filing requirements or fees designed to protect the health, safety or welfare of state residents. For example, OGC Legal Opinion 92-0638, available on the agency website, contains a thorough discussion of federal preemption in the context of a state law pertaining to registration of credit card issuers.

Finally, while we conclude that federal law preempts local law in this case, we would like to highlight that the Act, NCUA and other federal regulations contain significant consumer protections for all member loans. For example, FCUs are subject to an 18 percent interest rate ceiling and the Act prohibits charging prepayment penalties. 12 U.S.C. 1757(5)(A)(vi); 12 U.S.C. §1757(5)(a)(viii); 12 C.F.R. §701.21(c)(7)(ii)(B). NCUA's regulation governing credit practices prohibits an FCU from assessing a late fee on an otherwise timely monthly payment simply because a late fee assessed on an earlier payment remains unpaid. 12 C.F.R. §706.4.

We hope you find this correspondence helpful. Please let us know if we may be of further assistance.

Sincerely,

/s/

Sheila A. Albin  
Associate General Counsel

GC/RPK/SAA:bhs  
04-0727