DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 1, 7, and 23

[Docket No. 01–13]

RIN 1557–AB94

Investment Securities; Bank Activities and Operations; Leasing

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is publishing this final rule to amend its rules governing investment securities, bank activities and operations, and leasing. The revisions to the investment securities regulations incorporate the authority to underwrite, deal in, and purchase certain municipal bonds that is provided to well capitalized national banks by the Gramm-Leach-Bliley Act (GLBA). The final rule also makes the following revisions to the bank activities and operations regulations: it establishes the conditions under which a school where a national bank participates in a financial literacy program is not considered a branch under the McFadden Act; it revises the OCC's regulation governing bank holidays so that the wording of the rule conforms with the statute that authorizes the Comptroller to declare mandatory bank closings; it clarifies the scope of the term ''NSF fees'' for purposes of 12 U.S.C. 85, the statute that governs the rate of interest that national banks may charge; it simplifies the OCC's current regulation governing national banks' non-interest charges and fees; and it provides that State law applies to a national bank operating subsidiary to the same extent as it applies to the parent national bank. Finally, the revisions to the leasing regulations authorize the OCC to vary the percentage limit on the extent to which a national bank may rely on estimated residual value to recover its costs in personal property leasing arrangements. The purpose of these changes is to update and revise the OCC's regulations to keep pace with developments in the law and in the national banking system.

EFFECTIVE DATE: August 1, 2001.

FOR FURTHER INFORMATION CONTACT: For questions concerning 12 CFR 1.2, contact Beth Kirby, Special Counsel, Securities and Corporate Practices Division, (202) 874–5210. For questions concerning 12 CFR 7.3000, contact Michele Meyer, Counsel, Legislative and Regulatory Activities Division, (202) 874–5090. For questions concerning 12 CFR 7.1021, 7.4001, 7.4002 and 7.4006, contact Michele Meyer, Counsel, or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities Division, (202) 874–5090. For questions concerning 12 CFR 23.21, contact Steven Key, Senior Attorney, Bank Activities and Structure Division, (202) 874–5300.

SUPPLEMENTARY INFORMATION:

Introduction and Overview of Comments Received

On January 30, 2001, the OCC published in the **Federal Register** a notice of proposed rulemaking (the NPRM, proposed rules, or the proposal) concerning its rules governing investment securities, bank activities and operations, and leasing. *See* 66 FR 8178. The proposed revisions to the investment securities regulations incorporated the authority to underwrite, deal in, and purchase certain municipal bonds that is provided to well capitalized national banks by the Gramm-Leach-Bliley Act (GLBA). The proposed rules also contained several revisions to the OCC's bank activities and operations regulations. First, it established the conditions under which a school where a national bank participates in a financial literacy program is not considered a branch under the McFadden Act. Second, it revised the OCC's regulation governing bank holidays so that the wording of the rule conforms with the statute that

authorizes the Comptroller to declare mandatory bank closings. Third, the proposal clarified the scope of the term ''NSF fees'' for purposes of 12 U.S.C. 85, the statute that governs the rate of interest that national banks may charge. Fourth, it simplified the OCC's current regulation governing national banks' non-interest charges and fees. Fifth, it provided that State law applies to a national bank operating subsidiary to the same extent as it applies to the parent national bank. The proposal also contained revisions to the leasing regulations that authorized the OCC to vary the percentage limit on the extent to which a national bank may rely on estimated residual value to recover its costs in personal property leasing arrangements.

The OCC received approximately 30 comments in response to the proposed rules. Commenters included national banks, bank trade associations, consumer groups, members of Congress, State regulators, and individuals. The OCC received only one comment on the proposal to amend part 1 and three on the proposed revision to part 23. The majority of the comments concerned the proposed revisions to part 7. A number of these comments addressed the definition of ''interest'' for purposes of 12 U.S.C. 85 (revised § 7.4001(a)) and whether that definition should include some portion of the fee imposed by a national bank when it pays a check notwithstanding that its customer's account contains insufficient funds to cover the check. The remaining part 7 comments addressed the proposed changes to the OCC's current regulation governing national banks' non-interest charges and fees (revised § 7.4002) and proposed new § 7.4006, which addresses the applicability of State law to a national bank operating subsidiary.

The OCC is adopting most of the provisions we proposed without substantive changes. We have, however, modified certain provisions of the proposal in light of the comments we received. The most significant comments, and the OCC's responses, are discussed in the following section-by-section analysis.

Section-by-Section Description of the Final Rule

A. Part 1—Investment Securities

Pursuant to 12 U.S.C. 24(Seventh), the total amount of investment securities of any one obligor held by a national bank for its own account generally may not exceed 10 percent of the bank's capital and surplus. Section 24(Seventh), however, exempts certain types of securities from this limitation and permits a bank to underwrite, deal in, and purchase those securities without quantitative restriction. Section 151 of GLBA [1] amended section 24(Seventh) to exempt certain municipal bonds from the 10-percent limit and to permit a national bank to underwrite, deal in and purchase those securities without limit, if the national bank is well capitalized under the statutory and regulatory prompt corrective action standards.[2] In the NPRM, we proposed to amend part 1 of our regulations, which implements the statutory investment securities provisions, to reflect this change in the statute.

Part 1 classifies permissible national bank investment securities into several categories, or types.[3] Type I securities are securities—such as obligations issued by, or backed by the full faith and credit of, the United States—that a national bank may purchase, sell, deal in, and underwrite without regard to any capital and surplus limitation. The proposal made several changes to part 1. First, it added new § 1.2(g), which defines the municipal bonds described in section 151 of GLBA. As defined, the term ''municipal bonds'' means obligations of a State or political subdivision other than general obligations, and includes, *inter alia,* limited obligation bonds, revenue bonds, and obligations that satisfy the requirements of section 142(b)(1) of the Internal Revenue Code of 1986, issued by or on behalf of any State or political subdivision of a State, including any municipal corporate instrumentality of 1 or more States, or any public agency or authority of any State or political subdivision of a State.

Second, we proposed amending the list of Type I securities, which appears in redesignated § 1.2(j) of the regulation, to add the municipal bonds as defined in new § 1.2(g), subject to the requirement that the bank be well capitalized. The proposal applied the definition of well capitalized that the OCC uses for purposes of prompt corrective action standards.[4]

In addition, we proposed modifying the section that defines certain Type II securities, newly designated as § 1.2(k), to make it clear that obligations issued by a State or political subdivision or agency of a State, for housing, university, or dormitory purposes are Type II securities only when they do not qualify as Type I securities (which would result if the subject bank is not well capitalized under prompt corrective action standards). We also proposed modifying the paragraph that defines Type III securities (newly redesignated as § 1.2(l)) and uses municipal bonds as an example of that type, to make clear that municipal bonds are Type III securities only when they do not qualify as Type I securities (again, as a result of the national bank not being well capitalized). As we noted in the preamble to the proposal, regardless of the treatment of municipal bonds, safe and sound underwriting practices require a national bank to understand the fiscal condition of any municipality in whose bonds the bank invests.

The OCC received only one comment on the proposed changes to Part 1. The commenter pointed out that municipal bonds can be Type II securities as well as Type I or Type III securities. The commenter suggested that the OCC revise section 1.2 to clarify that municipal bonds that are Type III securities would include only those municipal bonds that do not satisfy the definition of Type I or Type II securities.

We agree with this commenter, and the final rule reflects this change from the proposal. Thus, under the final rule, a national bank that is well capitalized may deal in, underwrite, purchase, and sell municipal bonds for its own account without any limit tied to the bank's capital and surplus. This authority applies to *all* municipal bonds. If the bank is *not* well capitalized, then the universe of municipal bonds is divided into two types: (a) Municipal bonds that are investment securities representing obligations issued by a State, or a political subdivision or agency of a State, for housing, university, or dormitory purposes, and (b) all other types of municipal bonds. The former are treated as Type II securities, while the latter are treated as Type III securities.[5]

[1] Pub. L. 106–102, section 151, 113 Stat. 1338, 1384 (November 12, 1999).

[2] 12 U.S.C. 1831*o* (statutory prompt corrective action standards); 12 CFR part 6 (OCC's implementing regulation).

[3] *See, e.g.,* 12 CFR 1.2(i) and 1.3(a) (defining Type I securities and providing that Type I securities are not subject to the 10 percent capital and surplus limit); 12 CFR 1.2(j) and 1.3 (defining Type II securities and describing the quantitative limit); and, 12 CFR 1.2(k) and 1.3(c) (defining Type III securities and describing the quantitative limit).

[4] *See* 12 CFR 6.4(b)(1) (defining the term ''well capitalized'').

[5] While a bank's transactions in either Type II and Type III securities are limited to 10 percent of the bank's capital and surplus (*see* 12 CFR 1.3(b) and (c)), a national bank may deal in, underwrite, purchase, and sell for its own account Type II securities while the bank may only purchase and sell for its own account Type III securities. Regardless of how a municipal bond is designated, it must satisfy the requirement set out in part 1 that the bond be an ''investment security,'' as that term is defined. *See* 12 CFR 1.2(e).

The other proposed changes to part 1 are adopted without modification in the final rule.

B. Part 7—Bank Activities and Operations

The final rule makes five changes to part 7. First, it adds new § 7.1021, which defines the circumstances under which a bank that participates in a financial literacy program at a school is not considered to have established a branch of the bank under the McFadden Act. Second, the final rule amends § 7.3000 to conform it with the Comptroller's statutory authority to declare mandatory bank closings, as provided in 12 U.S.C. 95(b)(1). Third, the final rule revises current § 7.4001 to clarify the scope of the term ''NSF fees'' for purposes of 12 U.S.C. 85. Fourth, the final rule revises current § 7.4002, which governs non-interest charges and fees, to remove language that may be confusing. Finally, the final rule adds new § 7.4006, which provides that State laws apply to a national bank operating subsidiary to the same extent that they apply to the parent national bank. These changes are discussed below.

Bank Participation in Financial Literacy Programs (New § 7.1021)

The proposal added new § 7.1021(b) to provide that a school's premises or facility where a national bank participates in a financial literacy program is not a branch of the national bank under the McFadden Act [6] if the bank does not ''establish and operate'' the school premises or facility. The proposal was derived from the text of the statute, which describes the circumstances under which a national bank may ''establish and operate'' new branches and defines the term ''branch,'' [7] and from Federal judicial precedents determining when an off-premises location is a branch under these standards. Under those precedents, the court first determines whether the national bank has ''establish[ed] and operate[d]'' the off-premises location in question. If not, then the location will not be considered a ''branch'' for purposes of 12 U.S.C. 36.[8]

Consistent with the statute and applicable precedent, the proposed rule stated that a bank may participate in a financial literacy program if the bank does not establish or operate the school premises or facility on which the program is conducted and the principal purpose of the program is educational. As noted in the proposal, a program would be considered principally educational if it is designed to teach students the principles of personal economics or the benefits of saving for the future, without being designed for the purpose of making profits.[9]

The OCC received only supportive comments on proposed new § 7.1021(b) and adopts it without modification in the final rule.

Bank Holidays (Revised § 7.3000)

Under 12 U.S.C. 95(b)(1), in the event of natural or other emergency conditions existing in any State, the Comptroller may proclaim any day a legal holiday for national banks located in that State or affected area. In such a case, the Comptroller may require national banks to close on the day or days designated. If a State or State official designates any day as a legal holiday for ceremonial or emergency reasons, a national bank may either close or remain open unless the Comptroller directs otherwise by written order.

The NPRM proposed amending 12 CFR 7.3000, which implements 12 U.S.C. 95(b)(1), to more closely conform with the statute. The OCC received no comments on this portion of the proposal, and the final rule adopts § 7.3000 without change. Thus, under the final rule, if the Comptroller or a State declares a legal holiday due to emergency conditions, a national bank may temporarily limit or suspend operations at its affected offices or it may choose to continue its operations unless the Comptroller by written order directs otherwise.

Definition of ''Interest'' for Purposes of 12 U.S.C. 85 (Revised § 7.4001(a))

The OCC proposed revising § 7.4001 to clarify the scope of the term ''NSF fees'' for purposes of 12 U.S.C. 85. Section 85 governs the interest rates that national banks may charge, but it does not define the term ''interest.'' Section 7.4001 generally defines the charges that are considered ''interest'' for purposes of section 85, and then sets out a nonexclusive list of charges covered by that definition. The list includes ''NSF fees.''

The inclusion of ''NSF fees'' in the definition of ''interest'' was intended to codify a position the OCC took in Interpretive Letter 452, issued in 1988.[10] IL 452 concluded that charges imposed by a credit card bank on its customers who paid their accounts with checks drawn on insufficient funds were ''interest'' within the meaning of section 85. The charges were referred to as ''NSF charges'' in the letter. The term, however,is also is commonly used to refer to fees imposed by a bank on its checking account customers whenever a customer writes a check against insufficient funds, regardless of whether the check was intended to pay an obligation due to the bank. These different uses of the term ''NSF fees'' have created ambiguity about the scope of the term as used in § 7.4001(a).

The proposal invited comments on a change to § 7.4001(a) that would clarify that the term ''NSF fees'' includes only those fees imposed by a *creditor* bank when a borrower attempts to pay an obligation to that bank with a check drawn on insufficient funds. Fees that a bank charges for its deposit account services—including overdraft and returned check charges—are not covered by the term ''NSF fees'' as that term is used in § 7.4001(a). The OCC received no objections on that proposed change, and, therefore, we adopt it in the final rule as proposed. change. Thus, we are clarifying the definition of ''interest'' by stating in the final rule that interest

[6] This proposal is consistent with the limitation, found in 12 U.S.C. 93a, which states that the general rulemaking authority vested in the OCC by that section ''does not apply to section 36 of [Title 12 of the United States Code].'' This limitation simply makes clear that section 93a does not expand whatever authority the OCC has pursuant to other statutes to adopt regulations affecting national bank branching. Congress clearly contemplated that the OCC would implement section 36, as is evidenced by the repeated references to obtaining the OCC's approval throughout that section (*see, e.g.,* paragraphs (b)(1), (b)(2), (c), (g), and (i) of section 36). It would be illogical to conclude that the OCC, in implementing the provisions requiring national banks to obtain the OCC's prior approval under the sections cited, cannot interpret what the terms of the statute mean or that the interpretation must be made on a case-by-case basis. This rulemaking simply clarifies a situation that falls outside the branching restrictions imposed by section 36.

[7] *See* 12 U.S.C. 36(c) (describing the circumstances under which a national bank may ''establish and operate'' new branches); 12 U.S.C. 36(j) (defining the term ''branch'' to include ''any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent.'').

[8] *See, e.g., First National Bank in Plant City* v. *Dickinson,* 396 U.S. 122, 126–29, 134–37 (1969); *Cades* v. *H & R Block, Inc.,* 43 F.3d 869, 874 (4th Cir. 1994).

[9] Students in the financial literacy program need not be of any particular age or income background in order for the program to be eligible under this proposal. If the students are low- or moderate-income individuals, however, a bank's participation in a school savings program may also be given positive consideration under the Community Reinvestment Act as a community development service. *See* Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, 64 FR 23, 618 (May 3, 1999) (Q and A 3 addressing 12 CFR 25.12(j), 228.23(j), 345.23(j), and 563e.12(i) (examples of community development services)).

[10] Interpretive Letter No. 452 (Aug. 11, 1988), *reprinted in* [1988–89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 (IL 452).

includes *creditor-imposed* NSF fees that are charged when a borrower tenders payment on a debt with a check drawn on insufficient funds.

We also invited comment on whether the term ''NSF fees'' as used in § 7.4001(a) should include at least some portion of the fee imposed by a national bank in the more common scenario when it pays a check notwithstanding that its customer's account contains insufficient funds to cover the check. We received numerous comments on this issue, the majority of which opposed including in the definition of ''interest'' any portion of the fee imposed by a national bank when it pays an overdraft.[11] Commenters raised a number of complex and fact-specific concerns related to inclusion of any portion of a charge imposed in connection with paying an overdraft constitutes ''interest'' for purposes of section 85. Accordingly, we have not amended § 7.4001(a) to address this issue.

National Bank Non-Interest Charges (Revised § 7.4002)

Current § 7.4002 sets out the basic authority to impose non-interest charges and fees, including deposit account service charges. It provides that the decision to do so and the determination of the amounts of charges and fees are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. It also provides that a bank ''reasonably establishes'' non-interest charges and fees if it considers, among other factors, the four factors enumerated in the regulation. As noted in the preamble to the proposal, the OCC construes § 7.4002 to mean that a national bank that considers at least these four factors in setting its non-interest charges and fees has satisfied the requirement that the charges and fees be set according to safe and sound banking principles and, therefore, faces no supervisory impediment to exercising the authority to set charges and fees that the regulation describes.[12]

The proposal was intended to eliminate certain ambiguities in the text of § 7.4002 without altering the substance of the regulation or the way in which the OCC intends that it operate. First, the proposal eliminated two examples in § 7.4002(a) of the types of non-interest charges and fees that national banks may impose: charges a bank's board determines to be reasonable on dormant accounts and reasonable fees for credit reports or investigations. The OCC removed these examples in the proposal because the explicit reference to the two types of fees is unnecessary and could be misinterpreted as a limitation on a national bank's ability to charge other types of fees. We note, however, that dormant account charges and fees for credit reports and investigations continue to be permissible non-interest charges and fees even though they are no longer specifically mentioned in the rule.

One commenter objected to the removal of the examples concerning the imposition of reasonable deposit account service charges and reasonable fees for credit reports or investigations. This commenter believed that removing these examples removed a requirement that non-interest charges and fees be reasonable. However, as noted below in the discussion of the proposed changes to § 7.4002(b), this comment misconstrues the OCC's regulation. The imposition of non-interest charges and fees is governed by the standards set out in § 7.4002(b), as revised (namely, that the charges and fees be arrived at on a competitive basis and be made according to sound banking judgment and safe and sound banking principles). If a bank adheres to those standards, the OCC will not substitute its judgment about how much a bank should charge for a given product or service. Thus, we have concluded that it is unnecessary to retain the examples in § 7.4002(a), and have, accordingly, adopted the changes as proposed.

We also proposed to amend § 7.4002(b), to clarify what a bank's obligations are under that section. Previously, the sentence in § 7.4002(b) that introduces the four factors provided that a bank ''reasonably establishes'' non-interest charges and fees if it considers those factors among others. The proposal revised that sentence to say that a bank establishes non-interest charges and fees ''in accordance with safe and sound banking principles'' if it employs a decision-making process through which it considers the four factors. This new language was intended to convey that the bank must exercise sound banking judgment and rely on safe and sound banking principles in setting charges and fees.

As proposed, § 7.4002(b) was also revised to clarify that the authorization it contains to establish fees and charges necessarily includes the authorization to decide the amount and method by which they are computed. Thus, for example, fees resulting from the method the bank employs to post checks presented for payment are included within the authorization provided by § 7.4002.

The OCC received several comments on the proposed change to § 7.4002(b), both from those favoring its adoption and those opposed. The latter were concerned that removing the ''reasonably establishes'' language eliminates an implied limitation on the fees a national bank may charge. We have never construed this language to permit the OCC to substitute its judgment about the appropriate pricing of a product or service for a bank's judgment, however. As the current text of the regulation says, the amount and type of fees established by a national bank are decisions committed to the business judgment of the bank. The ''reasonably establishes'' language was intended to describe the process of exercising that judgment; it was never intended to limit a national bank's authority to exercise its business judgment.

Accordingly, like the proposal, the final rule clarifies that consideration of the four factors is a process requirement to be implemented by the bank and more clearly establishes the connection between the required process and the safety and soundness considerations that underlie it. The four factors are the same as under the current regulation, including the factor addressing the maintenance of the bank's safety and soundness. We expect that, pursuant to this factor, a bank would consider any risks, such as reputation or litigation risk, that would be affected by the imposition of a particular fee. We note that consideration of the four factors is relevant both when establishing a new fee and when changing a fee that already has been established. The reference to factors other than the four that are enumerated in § 7.4002(b) has been retained in the final rule in order to avoid creating any doubt about a national bank's ability to rely on factors

[11] In the most recent Federal case related to this issue of which the OCC is aware, the court held that overdraft fees were not ''interest'' within the meaning of 12 U.S.C. 85 and current § 7.4001(a). *Video Trax, Inc.* v. *NationsBank, N.A.,* 33 F. Supp. 2d 1041 (S.D. Fla. 1998); *aff'd per curiam* 205 F.3d 1358 (11th Cir. 2000); *cert. denied,* 121 S.Ct. 66 (2000).

[12] *See* Brief *Amicus Curiae* of the Office of the Comptroller of the Currency in Support of National Bank Plaintiffs, *Bank of America, N.A.* v. *San Francisco,* No. C 99 4817 VRW (N.D. Ca.) (citing OCC opinion letters construing and describing the operation of 12 CFR 7.4002). On July 11, 2000, the U.S. District Court for the Northern District of California granted the plaintiffs in this case permanent injunctive relief against San Francisco and Santa Monica city ordinances that purported to prohibit national banks from charging fees for providing banking services through automatic teller machines (ATMs). The case is currently pending appeal in the U.S. Court of Appeals for the Ninth Circuit.

in addition to those stated in the regulation.

The OCC also proposed to amend § 7.4002(d), which addresses our evaluations of whether Federal law preempts State laws that purport to limit or prohibit a national bank's ability to impose a charge or fee. The first clause of former § 7.4002(d) stated that the OCC evaluates on a case-by-case basis whether a national bank may establish fees pursuant to § 7.4002(a) and (b); the second clause provided that, in determining whether a State law purporting to limit or prohibit such fees is preempted, the OCC applies preemption principles derived from the Supremacy Clause of the United States Constitution and applicable judicial precedent. While the first clause simply underscored that a national bank's establishment of fees is governed by the preceding paragraphs of § 7.4002, it has been construed by some as requiring the OCC's confirmation prior to a bank charging a fee that the process followed by the bank in setting the fee conformed to the § 7.4002(b) factors and raises no safety and soundness concerns. To clarify that OCC confirmation is *not* required, we proposed to remove the first clause from § 7.4002(d) and retain only a statement that is intended to convey that the law as articulated by the Supreme Court and the lower Federal courts governs issues of Federal preemption.

We received a number of comments on proposed § 7.4002(d), many of which expressed concern that the proposed clarifying changes were, in fact, substantive changes to the rule. Several questioned whether the removal of the case-by-case evaluation language in former § 7.4002(d) meant that the OCC is seeking to eliminate case-by-case analyses of preemption questions. As previously noted, the reference in former § 7.4002(d) to paragraphs (a) and (b) have caused some to interpret § 7.4002(d) as *requiring* banks to seek our confirmation that the process followed by a given bank raises no safety and soundness concerns. In order to avoid this confusion going forward, the OCC proposed to remove the reference to the case-by-case evaluation of whether a national bank establishes its non-interest charges and fees pursuant to paragraphs (a) and (b) of § 7.4002. This does not, however, modify the OCC's practice of responding to requests for opinions on preemption questions on a case-by-case basis. We will continue to review these requests on a case-by-case basis and, in so doing, we will continue to apply the preemption standards articulated by the United States Supreme Court in *Barnett Bank of Marion County, N.A.* v. *Nelson,* 517 U.S. 25 (1996) and other applicable Federal judicial precedents. Minor changes to the language of the proposal have been made to clarify that point and to retain language from the former rule regarding the types of State laws at issue.

Several commenters also questioned the timing of the proposed changes to § 7.4002(d) in light of the pending appeal, in the U.S. Court of Appeals for the Ninth Circuit, of *Bank of America* v. *City of San Francisco,* Docket No. 00–16394. These commenters believe that by modifying the rule during litigation over its meaning, the OCC's proposal would have a chilling effect on State and municipal efforts to regulate national banks' fees. As explained above, our revisions to § 7.4002(d) do not change the OCC's process for evaluating whether State laws that limit or prohibit national banks' fees are preempted by the National Bank Act.[13]

Applicability of State Law to National Bank Subsidiaries (New § 7.4006)

Proposed § 7.4006 clarified that State laws apply to a national bank operating subsidiary to the same extent as those laws apply to the parent national bank. The majority of commenters who addressed this issue supported the proposal. Many of these commenters said that it is a permissible exercise of the authority granted by the National Bank Act for national banks to create operating subsidiaries that exercise both direct and incidental powers under 12 U.S.C. Section 24(Seventh). These commenters noted that operating subsidiaries have long been authorized for national banks and provide national banks with a convenient alternative to conduct activities that the bank could conduct directly. Further, they agreed that operating subsidiaries are, in essence, incorporated departments or divisions of the bank and, accordingly, should not be treated differently than their parent banks under State laws.[14]

A number of commenters, however, were opposed to the provision. These commenters read proposed § 7.4006 to mean that the OCC has concluded that certain types of State laws—several commenters mentioned licensing, corporate governance, and consumer protection laws in particular—do not apply to national bank operating subsidiaries. Some commenters also expressed a more general concern that Federal oversight of national bank operating subsidiaries is inadequate, and that States should be permitted to enforce compliance with State laws to protect the parent bank from any reputation or safety and soundness risks that may result from operating subsidiaries' noncompliance with those laws.

In our view, these comments do not warrant modification of proposed § 7.4006. For decades national banks have been authorized to use the operating subsidiary as a convenient and useful corporate form for conducting activities that the parent bank could conduct directly. Operating subsidiaries often have been described as the equivalent of departments or divisions of their parent banks.

Recent legislation has recognized this status of national bank operating subsidiaries. In GLBA, for example, Congress expressly acknowledged the authority of national banks to own subsidiaries that engage ''solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks.''[15] Similarly, the OCC operating subsidiary regulation provides that an operating subsidiary conducts its activities subject to the same authorization, terms, and conditions that apply to the conduct of those activities by its parent bank.[16] A fundamental component of these descriptions of the characteristics of operating subsidiaries in GLBA and the OCC's rule is that state laws apply to operating subsidiaries to the same extent as they apply to the parent national bank. Thus, unless otherwise provided by Federal law or OCC regulation, State laws, such as licensing requirements, are applicable to a national bank operating subsidiary only to the extent that they are applicable to national banks.[17]

[13] Although no substantive change is effected by the proposed revisions to § 7.4002(d), we note that the Supreme Court has held that the OCC may revise a rule during the pendency of litigation over matters governed by that rule. *See Smiley* v. *Citibank (South Dakota), N.A.,* 517 U.S. 735, 741 (1996) (upholding the OCC's regulation defining the term ''interest'' for purposes of 12 U.S.C. 85).

[14] Several commenters also requested that the final rule include, as an example, the express statement that 12 CFR 34 (Real Estate Lending and Appraisals) applies to operating subsidiaries. Inclusion of this statement in new § 7.4006 is unnecessary, however, because current § 34.1(b) already provides that part 34 applies to national banks and their operating subsidiaries.

[15] Pub. L. 106–102, § 121, 113 Stat. at 1378, *codified at* 12 U.S.C. 24a(g)(3).

[16] 12 CFR 5.34(e)(3).

[17] *See, e.g.,* Letter to Thomas A. Plant and Daniel Morton from Julie L. Williams, dated May 16, 2001 (published at 66 FR 28593 (May 23, 2001)) (Michigan law requiring national banks to obtain license to finance sales of motor vehicles would be preempted); letter to Thomas Vartanian from Julie L. Williams, dated March 7, 2000 (State licensing laws would be preempted to the extent that they apply to auction of certificates of deposit by

We disagree with those commenters who believe that new § 7.4006 will adversely affect the oversight of operating subsidiaries either from a consumer protection or a safety and soundness standpoint. The OCC considers the overall risk exposure of a national bank as part of its supervisory processes, including safety and soundness and compliance risk originating in, or resulting from, the bank's operating subsidiaries. Moreover, in specified cases, State law standards do apply both to a national bank and its operating subsidiary. For example, GLBA provides that insurance activities are to be functionally regulated by the States.[18] In its so-called safe-harbor provisions, section 104 of GLBA describes certain State insurance laws that are immune from preemption and that, therefore, apply to the conduct of insurance sales activities by either a depository institution or its subsidiary.

The preamble to the proposal noted that the Office of Thrift Supervision (OTS) has taken a similar approach with respect to the applicability of State law to the operating subsidiaries of Federal savings associations,[19] and that several courts have upheld this OTS rule.[20] Although the national banking laws differ in particular respects from the HOLA, national banks and Federal thrifts share the characteristics of a Federal charter. Like national banks, Federal thrifts are instrumentalities created by Congress for a national purpose—the HOLA was enacted in 1933 for the purpose of promoting home ownership in the United States. *See, e.g., Fidelity Federal Savings and Loan Ass'n* v. *de la Cuesta,* 458 U.S. 141, 152–53 (1982). Like national banks, the charter and powers of Federal thrifts derive exclusively from Federal law. The same preemption principles developed in Federal judicial precedents under the Supremacy Clause apply to both national banks and Federal thrifts. *See First National Bank of McCook* v. *Fulkerson,* No. 98–D–1024 (D. Co. March 7, 2000) slip op. at 7 (principle of Federal preemption applies similarly to national banks and Federal savings associations). Moreover, as with national banks, consideration of the special Federal character of Federal thrifts has informed courts' application of these traditional preemption principles. *See Conference of State Bank Supervisors* v. *Conover,* 710 F.2d 878, 881–83 (D.C. Cir. 1983) *(per curiam)* (applying *de la Cuesta* to conclude that OCC regulations governing adjustable rate mortgages preempted State law).

In view of these similarities, differences in outcome on questions about what State laws apply to national banks and Federal thrifts are not warranted unless a Federal law provides otherwise,[21] and similar conclusions should be reached regarding the application of State laws to national banks and their operating subsidiaries as are reached for Federal thrifts and their operating subsidiaries.

For these reasons, § 7.4006 is adopted as proposed.

C. Part 23—Leasing

Estimated Residual Value for Section 24 (Seventh) Leases (Revised § 23.21)

Twelve CFR 23 authorizes national banks to engage in leasing activities pursuant to two distinct sources of authority: 12 U.S.C. 24 (Tenth), which expressly authorizes leasing subject to certain conditions specified in that statute, including a 10%-of-assets limit on the amount of the activity that the national bank may conduct; and 12 U.S.C. 24 (Seventh), which authorizes leasing as an activity that is part of the business of banking without imposing a percentage-of-assets limit.[22] These leases must be ''full-payout leases.'' That term is defined to mean a lease in which the national bank reasonably expects to recover its investment in the leased property, plus its cost of financing, from rental payments, estimated tax benefits, and the estimated residual value of the leased property at the expiration of the lease term. The rules for section 24 (Seventh) leases further provide that the bank's estimate of the residual value of the leased property must be reasonable in light of the nature of the property and all the circumstances surrounding the lease transaction and that, in any event, the unguaranteed amount of residual value relied upon may not exceed 25% of the bank's original cost of the property. *See* 12 CFR 23.3, 23.2(e), and former § 23.21.

Because the OCC's experience supervising national banks that engage in the leasing business suggested that the 25% residual value limit may not be appropriate for all types of personal property leasing, we proposed to modify former § 23.21 to provide that the limit on the unguaranteed amount of estimated residual value is *either* 25% *or* the percentage for a particular type of personal property that is specified in guidance published by the OCC. This would permit the OCC to establish a different percentage requirement than 25% if a different limit is warranted. If the OCC does not specify a different limit, the 25% limit would continue to apply. In the proposal, we stated that we would apprise national banks of any different limit or limits established under this provision by publishing an OCC bulletin, which would subsequently be incorporated into the Comptroller's Handbook booklet on Lease Financing.

The OCC received several comments on the proposed changes to part 23 from national banks and bank trade groups questioning whether the proposal was establishing 25% as a floor or whether the OCC might intend to reduce the residual value limit. Those commenters argued, as a matter of policy, that the OCC should not lower the residual value limit below 25% and, as a matter of law, that the OCC would be required by the Administrative Procedure Act (APA), 5 U.S.C. 553(b), to use notice-and-comment rulemaking to effect any such reduction.

The OCC did not intend in the proposal to establish 25% as a floor. We believe that some types of leased property may warrant use of a higher or lower residual value. Establishing a 25% floor in § 23.21 would deprive the OCC of flexibility it may need in the future to respond to changes in the leasing business. Moreover, we do not believe that the APA's rulemaking requirements would be triggered by

national bank over the Internet) (published at 65 FR 15037 (March 20, 2000)); OCC Interpr. Ltr. No. 749 (Sept. 13, 1996), reprinted in [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) P 81–114 (State law requiring national banks to be licensed by the state to sell annuities would be preempted); OCC Interpr. Ltr. 644 (March 24, 1994) reprinted in [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) P 83,553 (State registration and fee requirements imposed on mortgage lenders would be preempted).

[18] Pub. L. 106–102, section; 301, 113 Stat. at 1407, 15 U.S.C. 6711.

[19] 12 CFR 559.3(n). *See* 61 FR 66561, 66563 (December 18, 1996) (preamble to OTS final rule adopting section 559.3(n), explaining that the basis for the OTS rule is that the operating subsidiary of a Federal savings association ''is treated as the equivalent of a department of the parent thrift for regulatory and reporting purposes'').

[20] *See WPS Financial, Inc.* v. *Dean,* No. 99 C 0345 C (W.D. Wi. Nov. 26, 1999); *Chaires* v. *Chevy Chase Bank, FSB,* 131 Md. App. 64, 748 A.2d 34, 44 (Md. Ct. Sp. App. 2000).

[21] *See, e.g.,* 12 U.S.C. 1462a(f) (stating that no provision of law administered by the Director of the Office of Thrift Supervision shall be construed as superseding any homestead provision of any State constitution or implementing statute in effect on September 29, 1994, or any subsequent amendment, that exempts the homestead of any person form foreclosure or forced sale for the payment of debts, other than a purchase money obligation relating to the homestead, taxes due on the homestead, or an obligation arising from work and material used in constructing improvements on the homestead). There is no comparable provision in the laws applicable to national banks.

[22] *M&M Leasing* v. *Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) (bank leasing of personal property permissible because it was functionally equivalent to loaning money on personal security).

such a supervisory response.[23] Pursuant to this rulemaking, we are amending our rule in a way that preserves flexibility for the OCC to apply a different limit when faced with a given set of facts. This enables the OCC to apply a different limit without having to amend its rule. Interested parties are, as a result of this rulemaking, informed that the OCC may exercise its discretion to apply the limit that it thinks appropriate in a given circumstance. Accordingly, we have adopted the rule as proposed.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short, explanatory statement in the **Federal Register** along with its rule.

Pursuant to section 605(b) of the RFA, the OCC hereby certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule implements statutory provisions and codifies caselaw and OCC interpretations, but adds no new requirements. Accordingly, a regulatory flexibility analysis is not needed.

Executive Order 12866

The OCC has determined that this final rule is not a significant regulatory action under Executive Order 12866.

Unfunded Mandates Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1532 (Unfunded Mandates Act), requires that the agency prepare a budgetary impact statement before promulgating any rule likely to result in a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires the agency to identify and consider a reasonable number of regulatory alternatives before promulgating the rule. The OCC has determined that this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more in any one year. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed any regulatory alternatives. As noted above, the final rule adds no new requirements.

Executive Order 13132—Federalism Summary Impact Statement [24]

Executive Order 13132 requires Federal agencies, including the OCC, to certify their compliance with that Order when they transmit to the Office of Management and Budget (OMB) any draft final regulation that has federalism implications. Under the Order, a regulation has federalism implications if it has ''substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.'' In the case of a regulation that has federalism implications and that preempts State law, the Order imposes certain specific requirements that the agency must satisfy, to the extent practicable and permitted by law, prior to the formal promulgation of the regulation.

In general, the Executive Order requires the agency to adhere strictly to Federal constitutional principles in developing rules that have federalism implications; provides guidance about an agency's interpretation of statutes that authorize regulations that preempt State law; and requires consultation with State officials before the agency issues a final rule that has federalism implications or that preempts State law.

It is not clear that Executive Order 13132 applies to this rulemaking. The proposed change to § 7.4002(d) and the proposed addition of new § 7.4006 were cited by some commenters as having the effect of preempting State law. However, as previously discussed, the changes to § 7.4002(d) are not intended to affect any substantive change in our rule governing non-interest charges and fees. Rather, those changes remove language that created the misimpression that the OCC must approve the process a bank used when deciding to impose a non-interest charge or fee. The changes do not affect the OCC's intention to address questions of preemption on a case-by-case basis, according to preemption principles derived from the United States Constitution, as interpreted through judicial precedent. Section 7.4006 generally provides that national bank operating subsidiaries are subject to State law to the extent State law applies to their parent bank. The section itself does not effect preemption of any State law; it reflects the conclusion we believe a Federal court would reach, even in the absence of the regulation, pursuant to the Supremacy Clause and applicable Federal judicial precedent.

Even if the Executive Order were applicable to this rule, the final rule satisfies the requirements of that Order. If an agency promulgates a regulation that has federalism implications and preempts State law, the Executive Order requires the agency to consult with State and local officials, to publish a ''federalism summary impact statement,'' and to make written comments from State and local officials available to the Director of OMB.

In addition to publishing our proposal for comment by all interested parties, including State and local officials, we also brought the proposal to the attention of the Conference of State Bank Supervisors and specifically invited its views, and the views of its constituent members, on the revisions we proposed. In the preamble to this final rule, we have described the comments we received from State officials or their representatives and our responses thereto. Finally, we have made those written comments we received from State or local officials available to the Director of OMB.

Effective Date

Any new regulation that imposes ''additional reporting, disclosure, or other requirements on insured depository institutions shall take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form,'' unless certain exceptions apply. Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103–325, § 302(b) (September 23, 1994). This rulemaking imposes no such additional reporting, disclosure, or other requirements. Accordingly, the requirement to delay the effective date until the first day of the next calendar quarter does not apply, and the rule will become effective 30 days after publication, in accordance with 5 U.S.C. 553(d).

[23] When adopting a rule, the APA requires that an agency provide notice to the public of: (1) what it proposes to do; and (2) the bases for its proposed actions. Kenneth Culp Davis & Richard J. Pierce, Jr. *Administrative Law* § 7.3. We have complied with these requirements in this rulemaking by providing public notice of the OCC's intention to modify former § 23.21, for the reasons discussed above, in such a way that will permit the OCC to establish a different percentage requirement than 25% if a different limit is warranted in the future.

[24] Executive Order 13132 provides that a ''federalism summary impact statement'' consists of a description of the extent of the agency's prior consultation with State and local officials, a summary of the nature of their concerns, the agency's position reflecting the need to issue the regulation, and a statement of the extent to which the concerns of State and local officials have been met. The following discussion, together with the preamble discussion concerning the provisions mentioned by the commenters on this issue, satisfies those requirements.

List of Subjects

12 CFR Part 1

Banks, banking, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 7

Credit, Insurance, Investments, National banks, Reporting and recordkeeping requirements, Securities, Surety bonds.

12 CFR Part 23

National banks.

Authority and Issuance

For the reasons set forth in the preamble, parts 1, 7 , and 23 of chapter I of title 12 of the Code of Federal Regulations are amended as follows:

PART 1—INVESTMENT SECURITIES

1. The authority citation for part 1 continues to read as follows:

Authority: 12 U.S.C. 1, *et seq.*, 12 U.S.C. 24(Seventh), and 93a.

2. In § 1.2, current paragraphs (g) through (m) are redesignated as (h) through (n), a new paragraph (g) is added, and newly designated paragraphs (j)(4), (k)(1), and (l) are revised to read as follows:

§ 1.2 Definitions.

* * * * *

(g) *Municipal bonds* means obligations of a State or political subdivision other than general obligations, and includes limited obligation bonds, revenue bonds, and obligations that satisfy the requirements of section 142(b)(1) of the Internal Revenue Code of 1986 issued by or on behalf of any State or political subdivision of a State, including any municipal corporate instrumentality of 1 or more States, or any public agency or authority of any State or political subdivision of a State.

* * * * *

(j) * * *

(4) General obligations of a State of the United States or any political subdivision thereof; and municipal bonds if the national bank is well capitalized as defined in 12 CFR 6.4(b)(1);

* * * * *

(k) * * *

(1) Obligations issued by a State, or a political subdivision or agency of a State, for housing, university, or dormitory purposes that would not satisfy the definition of Type I securities pursuant to paragraph (j) of § 1.2;

* * * * *

(*l*) *Type III security* means an investment security that does not qualify as a Type I, II, IV, or V security. Examples of Type III securities include corporate bonds and municipal bonds that do not satisfy the definition of Type I securities pursuant to paragraph (j) of § 1.2 or the definition of Type II securities pursuant to paragraph (k) of § 1.2.

* * * * *

PART 7—BANK ACTIVITIES AND OPERATIONS

3. The authority citation for part 7 is revised to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 92, 92a, 93, 93a, 481, 484, 1818.

4. A new § 7.1021 is added to subpart A to read as follows:

§ 7.1021 National bank participation in financial literacy programs.

A national bank may participate in a financial literacy program on the premises of, or at a facility used by, a school. The school premises or facility will not be considered a branch of the bank if:

(a) The bank does not establish and operate the school premises or facility on which the financial literacy program is conducted; and

(b) The principal purpose of the financial literacy program is educational. For example, a program is educational if it is designed to teach students the principles of personal economics or the benefits of saving for the future, and is not designed for the purpose of profit-making.

5. In § 7.3000, the last sentence of paragraph (b) is removed and two sentences are added in its place to read as follows:

§ 7.3000 Bank hours and legal holidays.

* * * * *

(b) * * * When the Comptroller, a State, or a legally authorized State official declares a legal holiday due to emergency conditions, a national bank may temporarily limit or suspend operations at its affected offices. Alternatively, the national bank may continue its operations unless the Comptroller by written order directs otherwise.

* * * * *

6. In § 7.4001, the second sentence of paragraph (a) is revised to read as follows:

§ 7.4001 Charging interest at rates permitted competing institutions; charging interest to corporate borrowers.

(a) * * * It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, creditor-imposed not sufficient funds (NSF) fees charged when a borrower tenders payment on a debt with a check drawn on insufficient funds, overlimit fees, annual fees, cash advance fees, and membership fees. * * *

* * * * *

7. Section 7.4002 is revised to read as follows:

§ 7.4002 National bank charges.

(a) *Authority to impose charges and fees.* A national bank may charge its customers non-interest charges and fees, including deposit account service charges.

(b) *Considerations.* (1) All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.

(2) The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others:

(i) The cost incurred by the bank in providing the service;

(ii) The deterrence of misuse by customers of banking services;

(iii) The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and

(iv) The maintenance of the safety and soundness of the institution.

(c) *Interest.* Charges and fees that are ''interest'' within the meaning of 12 U.S.C. 85 are governed by § 7.4001 and not by this section.

(d) *State law.* The OCC applies preemption principles derived from the United States Constitution, as interpreted through judicial precedent, when determining whether State laws apply that purport to limit or prohibit charges and fees described in this section.

(e) *National bank as fiduciary.* This section does not apply to charges imposed by a national bank in its capacity as a fiduciary, which are governed by 12 CFR part 9.

8. A new § 7.4006 is added to read as follows:

§ 7.4006 Applicability of State law to national bank operating subsidiaries.

Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.

PART 23—LEASING

9. The authority citation for part 23 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 24(Seventh), 24(Tenth), and 93a.

10. In § 23.21, paragraph (a)(2) is revised to read as follows:

§ 23.21 Estimated residual value.

* * * * *

(a) * * *

(2) Any unguaranteed amount must not exceed 25 percent of the original cost of the property to the bank or the percentage for a particular type of property specified in published OCC guidance.

* * * * *

Dated: June 21, 2001.

John D. Hawke, Jr.,

Comptroller of the Currency.

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