Interpretations—July 1 to September 30, 2003

Interpretive Letters

968–February 12, 2003

12 USC 85

Dear [ ]:

This is in response to your inquiry on behalf of [ ] ("bank") and [ ] ("Co."). In that letter, you request confirmation that after [Co.], currently a holding company affiliate of the bank, becomes an operating subsidiary of the bank, it may rely on 12 USC 85 to impose and export interest charges permitted by North Carolina law on consumer loans that it makes in North Carolina and throughout the United States. For the reasons described below, after it becomes a national bank operating subsidiary, [Co.] may impose and export North Carolina interest charges under the same terms and conditions applicable to the bank.[1]

Both the bank and [Co.] are headquartered in North Carolina. [Co.] makes consumer loans secured by first or subordinate liens on one- to four-family residential real estate.2 The bank, through [Co.], seeks to establish nationwide lending programs with uniform national pricing policies based on the laws of its home state, North Carolina. [Co.] would include in its loan documents a governing law clause disclosing to borrowers that interest, including loan fees considered to be interest under federal law, would be governed by federal and North Carolina law. [Co.] also would comply with all requirements and limitations imposed by section 85 and OCC regulations and interpretations regarding section 85.

Because [Co.] will be a subsidiary of the bank within the meaning of 12 CFR 5.34(e)(2), and will engage solely in activities that are permissible for the bank to engage in directly, [Co.] will qualify as an operating subsidiary of the bank under 12 CFR 5.34. As such, it will be subject to the same terms and conditions that apply to the bank. As stated in the relevant OCC regulations—

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[1] Our review of the preemption issues involved in the bank's inquiry is not subject to the notice-and-comment procedures required under certain circumstances by 12 USC 43. That provision requires the OCC to publish in the *Federal Register* notice of any preemption inquiry concerning a state law in the areas of community reinvestment, consumer protection, fair lending, and the establishment of interstate branches. However, notice is not required for requests that raise issues of federal preemption that are essentially identical to those on which we have previously issued an opinion letter or interpretive rule. *Id.* section 43(c)(1)(A). As explained in this letter, the request involves two issues that are resolved by OCC regulations: (1) the ability of a national bank to export interest rates (*see* 12 CFR 7.4001(c)), and (2) the extent to which state law applies to an operating subsidiary of a national bank (*see id.* sections 5.34(e)(3) and 7.4006). This letter simply outlines the relationship between these two well-settled principles of federal banking law.

[2] [Co.] plans to sell the majority of the first lien secured loans to secondary market investors, such as Fannie Mae. The subordinate lien secured loans likely would be transferred to the bank, securitized, or sold to private investors.

> *Examination and supervision*. An operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms, and conditions that apply to the conduct of such activities by its parent national bank.[3]

Elsewhere, our regulations specify that "[s]tate laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."[4] Recent legislation also has recognized the permissibility of national banks engaging in activities through operating subsidiaries. In section 121 of the Gramm–Leach–Bliley Act, Congress expressly acknowledged that national banks may 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."[5] Operating subsidiaries are often described as equivalent to a department or division of their parent bank, and our regulations ensure that operating subsidiaries will be subject to the same federal laws and standards that govern their parent bank, including any state laws and standards that are made applicable to the parent bank by federal law.[6]

One such law is section 85 governing the interest a national bank may charge. Under section 85, a national bank is authorized to establish interest based on the laws of the state in which the bank is located.[7] OCC regulations provide that:

> A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state.[8]

This "most favored lender" lender status permits a national bank to contract with borrowers in any state for interest at the maximum rate permitted by the law of the state in which the national bank is located. Generally, that is the state in which the main office of the national bank is located.[9] Under certain circumstances, national banks with branches in more than one state may be required to impose interest rates permitted by the law of a state in which they have a branch. That would happen in circumstances where three functions—loan approval, communication of loan approval, and disbursal of loan proceeds—all occur in a branch or branches in the same branch

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

[4] 12 CFR 7.4006.

[5] Pub. L. No. 106–102, § 121, 113 Stat. at 1378, *codified at* 12 USC 24a(g)(3).

[6] Letter from Charles F. Byrd, assistant director, Legal Advisory Services Division (October 30, 1977), *reprinted in* [1978–1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,051 (national bank operating subsidiaries are in effect incorporated departments of the bank).

[7] 12 USC 85.

[8] 12 CFR 7.4001(b).

[9] *Marquette National Bank of Minneapolis* v. *First of Omaha Service Corp,* 439 U.S. 299 (1978).

state.[10] Absent this set of circumstances, a national bank may impose rates permitted by the state where its main office is located.

Accordingly, pursuant to 12 CFR 5.34(e)(3) and 7.4006, the amount of interest [Co.] may charge is governed by section 85 to the same extent as section 85 is applicable to its parent bank.[11]

I hope the foregoing is helpful in your analysis of your client's lending programs. Please do not hesitate to contact my office at (202) 874-5200; MaryAnn Nash, counsel, in our Law Department, at (202) 874–5090; or Jerome L. Edelstein, senior counsel, in our Law Department at (202) 874–5300, if you have any questions or if you need any additional information.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[10] OCC Interpretive Letter No. 822 (Feb. 17, 1998), *reprinted in* [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–265.

[11] *See Moss* v. *Southtrust Mobile Services, Inc.*, No. CV–95–P–1647–W, 1995 U.S. District Court LEXIS 21770 (Northern District of. Alabama, September 22, 1995). In this case, the court concluded, without analysis, that section 85 applied to the operating subsidiary in question pursuant to 12 CFR 5.34 because it was an operating subsidiary of a national bank.

969–April 28, 2003

12 CFR 9.18
12 CFR 9.12

RE: Collective Fund Limited to Funds Awaiting Investment or Distribution

Dear [ ]:

This is in response to your February 5, 2003 letter, and subsequent discussions with Joel Miller, concerning [ ]'s (the "bank's") desire to pool the funds of individual fiduciary accounts and self-deposit[1] them collectively in a 12 CFR 9.18(a)(1) short-term investment fund ("STIF"). The STIF would consist exclusively of funds awaiting investment or distribution and would operate in accordance with all applicable provisions of 12 CFR 9.18. Based on your representations, and for the reasons set forth below, we conclude that the bank may pool the individual fiduciary accounts and self-deposit them in the STIF.

Discussion

The bank currently serves as trustee, executor, administrator, guardian, and in other fiduciary capacities for thousands of its trust customers. As fiduciary, the bank receives and invests fiduciary cash and other assets and makes distributions to beneficiaries.

The bank seeks to pool and self-deposit fiduciary funds awaiting investment or distribution and to manage them collectively through a STIF. The assets of the STIF will consist of short-term CDs of varying maturities, similar to assets of a money market fund, except that a portion (e.g., 10 percent) of the STIF assets may consist of checking or other "transaction" deposits that are needed to meet anticipated liquidity needs. The bank believes collective investment will enable customers to receive higher yields on funds awaiting distribution or investment without materially increasing the administrative burden on the bank. Each trust customer's account will reflect ownership of units in the STIF equivalent to the customer's proportionate share of the STIF net assets.

[1] Any deposits the bank makes of fiduciary funds in the commercial, savings, or other department of the bank are considered "self-deposits." 12 CFR 9.10(b).

Analysis

National banks are generally authorized to pool fiduciary funds and invest them collectively, including investment through STIFs.[2] Investing these fiduciary funds in the bank's own deposits, however, raises conflict of interest issues for the STIF. Twelve CFR 9.18(b)(8) requires a national bank administering a STIF to comply with the conflict of interest requirements of 12 CFR 9.12, which provides as follows—

> (a) *Investments for fiduciary accounts.*
> (1) *In general.* *Unless authorized by applicable law,* a national bank may not invest funds of a fiduciary account for which a national bank has investment discretion in the stock or obligations of, or in assets acquired from: the bank or any of its directors, officers, or employees; affiliates of the bank or any of their directors, officers, or employees; or individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank. (Emphasis by underlining added.)

Applicable law authorizes the bank to invest the STIF in the bank's own deposit obligations. Twelve CFR 9.2(b) defines applicable law to include, "any applicable federal law governing [fiduciary] relationships." Federal law includes Office of the Comptroller of the Currency (OCC) regulations, 12 CFR 9.10(b), which read in part as follows—

> (b) *Self-deposits*—(1) *In general.* A national bank may deposit funds of a fiduciary account that are awaiting investment or distribution in the commercial, savings, or another department of the bank, *unless prohibited by applicable law.* (Emphasis by underlining added.)

Part 9 was restructured and streamlined in 1995. The regulatory history of part 9 clearly shows that national banks have been permitted to self-deposit funds awaiting investment or distribution both before and after part 9 was revised.

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[2] See 12 CFR 9.18(a)(1) and 9.18(b)(4)(ii)(b). Twelve CFR 9.18(a)(1) states—

> *Where consistent with applicable law,* a national bank may invest assets that it holds as fiduciary in the following collective investment funds:
>
> (1) A fund maintained by the bank, or by one or more affiliated banks, exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act. [Footnotes omitted, emphasis by underlining added.]

The bank represents that it is consistent with applicable law for it to invest fiduciary assets in collective investment funds in those states in which it does business and plans to so invest fiduciary assets.

Before its revision, part 9 dealt with self-deposits of trust funds in three sections. Twelve CFR 9.18(b)(8)(i) (1993) expressly permitted STIFs to self-deposit funds awaiting investment or distribution; 12 CFR 9.12(a) (1993) prohibited conflicts of interest such as self-deposits of fiduciary funds unless "lawfully authorized by the instrument creating the relationship, or by court order or by local law"; and 12 CFR 9.10(b) (1993) permitted self-deposit of funds awaiting investment or distribution "unless *prohibited* by the instrument creating the trust or by local law." OCC precedents (described below) made it clear that in addition to the specific authorization for STIFs to self-deposit under 12 CFR 9.18(b)(8)(i) (1993), STIFs were subject to the provisions of 12 CFR 9.12 and 12 CFR 9.10(b). *See* Trust Interpretation 218 (May 24, 1989) and Trust Interpretation 258 (April 10, 1991) *infra*.

In 1995 the OCC deleted the express authorization for self-deposits of STIF funds in 12 CFR 9.18(b)(8)(i), and instead inserted a cross reference to 12 CFR 9.12. *See* 61 *Federal Register* 68543, at 68550 (Dec. 30, 1996). Adding the cross-reference to 12 CFR 9.12 effectively preserved the ability of STIFs to self-deposit subject to the same requirement under old part 9 that they comply with 12 CFR 9.12 and 12 CFR 9.10(b).

The OCC issued two letters under old part 9 confirming the ability of STIFs to self-deposit. In Trust Interpretation No. 218 (May 24, 1989), the OCC permitted a bank to self-deposit in a STIF provided that the STIF's investment objective was to, "provide a temporary investment for funds awaiting investment or distribution." The interpretation also included the qualification that, "it must be permissible for all accounts participating in the STIF to maintain funds in deposits of the Bank, *see* 12 C.F.R. § 9.10(b) and 12 C.F.R. § 9.12," demonstrating that the ability of the STIF to self-deposit was subject to those two regulations. Interpretation No. 218 was clarified by Trust Interpretation No. 258 (April 10, 1991) which noted that under 12 CFR 9.12, the exception for self-deposits of trust funds applied only when "lawfully authorized by the instrument creating the relationship, or by court order or by local law." As described above, that standard contained in 12 CFR 9.12 was changed in 1995 to permit self-deposits "if authorized by applicable law."

The bank represents that applicable law in those states in which it does business and plans to self-deposit fiduciary funds does not prohibit such self-deposits. As a result, 12 CFR 9.10(b) provides the applicable authority required by 12 CFR 9.12 for the bank to self-deposit fiduciary funds awaiting investment or distribution or to deposit such funds with affiliates, and this practice is not prohibited by applicable law.

Conclusion

Based on the foregoing, the bank may self-deposit fiduciary assets awaiting investment or distribution collectively in a STIF administered by the bank.

The bank confirms that it will comply with the requirements as to collateral for self-deposits imposed by 12 CFR 9.10 and with all other applicable requirements under part 9.

Lisa Lintecum
Director, Asset Management Division

970—June 25, 2003

12 USC 24(7)

Subject: [Bank, City, State] (NB)

Dear [ ]:

This is in response to your May 23, 2003, letter requesting confirmation that [NB] may lawfully acquire and hold a non-controlling equity interest in a limited purpose state-chartered bank ("bank").

Facts

The bank, now being organized, will be chartered in [State]. The bank will engage only in activities that are permissible for a banker's bank under 12 USC 24(Seventh) and 27(b).[1] However, the bank will not actually meet the qualifications for a banker's bank set forth in section 27(b) since it will not be owned exclusively (except for directors' qualifying shares) by other depository institutions or depository institution holding companies. Although such entities will hold the majority of the bank's shares, approximately 20 percent of the shares will be held by other shareholders. [NB]'s investment in the bank is expected to be between $100,000 and $250,000, or between 1 percent and 2½ percent of its capital. While [NB] may later invest additional amounts, you have represented that [NB]'s investment will at all times be less than 5 percent of the bank's total shares.[2]

The bank will engage in the following activities: (1) taking deposits from depository institutions; (2) buying and selling loan participations; (3) engaging in lending transactions permissible for a banker's bank; and (4) providing correspondent services to depository institutions.

[1] 12 USC 27(b)(1) provides that:

> "The Comptroller of the Currency may also issue a certificate of authority to commence the business of banking pursuant to this section to a national banking association which is owned exclusively (except to the extent directors' qualifying shares are required by law) by other depository institutions or depository institution holding companies and is organized to engage exclusively in providing services to or for other depository institutions, their holding companies, and the officers, directors, and employees of such institutions and companies, and in providing correspondent banking services at the request of other depository institutions or their holding companies (also referred to as a 'banker's bank')."

[2] Since [NB]'s investment in the bank will at no time reach 5 percent, this proposal raises no issues under the Bank Holding Company Act, 12 USC 1841 *et seq.*

Discussion

The Office of the Comptroller of the Currency (OCC) has traditionally recognized the authority of national banks to organize and perform any of their lawful activities in a reasonable and convenient manner not prohibited by law.[3] In a number of interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in an enterprise provided four criteria or standards are met. These standards, which have been distilled from our previous decisions in the area of permissible non-controlling investments for national banks and their subsidiaries, are:

> 1) The activities of the enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking (or otherwise authorized for a national bank).
>
> 2) The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.
>
> 3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.
>
> 4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Based upon the facts presented, [NB]'s proposed acquisition satisfies these four standards.

> 1) The activities of the enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking (or otherwise authorized) for a national bank.

The National Bank Act, in relevant part, provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing and circulating notes. . . .

[3] *See,* e.g.*,* Interpretive Letter No. 943, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–468 (July 24, 2002); Interpretive Letter No. 890, *reprinted in* [2000–2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–409 (May 15, 2000); Interpretive Letter No. 854, *reprinted in* [1998–1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–311 (February 25, 1999); Interpretive Letter No. 692, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995).

The Supreme Court has held that this powers clause of 12 USC 24(Seventh) is a broad grant of authority to engage in the business of banking, which is not limited to the five enumerated powers. Further, national banks are authorized to engage in an activity if it is incidental to the performance of the enumerated powers in the statute or if it is incidental to the performance of an activity that is part of the business of banking.[4]

All of the bank's proposed activities are permissible for a national bank. Two of the activities—taking deposits and making loans—are among the enumerated powers specifically authorized under 12 USC 24(Seventh).[5] The buying and selling of loan participations is also permissible.[6] Providing correspondent services to other depository institutions is authorized under the OCC Interpretive Ruling 7.5007, 12 CFR 7.5007.[7] The first standard is satisfied.

> 2) The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

This is an obvious corollary to the first standard. It is not sufficient that the entity's activities are permissible at the time a bank initially acquires its interest; they must also remain permissible for as long as the bank retains an ownership interest.

As a matter of corporate law, a minority shareholder in a corporation does not possess a veto power over corporate activities. Therefore, [NB] will lack the ability to restrict the bank's activities to those that are permissible for a national bank. However, the OCC has accepted as satisfaction of this criterion a national bank's ability to divest itself of its investment in any enterprise that engages in an activity that is not permissible for a national bank. *See,* e.g., Interpretive Letter No. 890, *supra,* n. 3. You have represented that nothing in the bank's articles of incorporation or bylaws prohibit or restrict the ability of a shareholder to sell its shares in the bank. Except for short-term limitations prescribed in the securities laws, any national bank that invests in the bank is free to sell its shares if the bank engages in any activity that is not permissible for a national bank. The second standard is satisfied.

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[4] *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.,* 513 U.S. 215 (1995).

[5] As noted above, the bank will engage in such transactions only with other depository institutions and not with the general public. Its proposed activities are therefore narrower than is permitted under 12 USC 24(Seventh).

[6] *See,* e.g., Interpretive Letter No. 755, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-119 (October 3, 1996) ("[N]ational banks long have been able to purchase mortgage-backed securities and engage in loan participations. *See* 12 USC 24(Seventh).")

[7] "It is part of the business of banking for a national bank to offer as a correspondent service to any of its affiliates or to other financial institutions any service it may perform for itself." 12 CFR 7.5007.

3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

(a) Loss exposure from a legal standpoint.

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that the national bank's investment not expose it to unlimited liability. This is not normally a concern when a national bank invests in a corporation, for it is generally accepted that a corporation is an entity distinct from its shareholders, with its own separate rights and liabilities, provided proper corporate separateness is maintained.[8] That is the case here. The bank will be a *[State]* corporation and the corporate veil will protect [NB] from liability or loss associated with its investment.[9]

(b) Loss exposure from an accounting standpoint.

In assessing a national bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's minority investment in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of accounting. *See,* e.g., Interpretive Letter No. 943, *supra,* n. 3. You have represented that [NB] will account for its ownership interest in the bank according to the cost method of accounting, which will satisfy the OCC's requirements in this regard.

Therefore, for both legal and accounting purposes, the [NB]'s potential loss exposure arising from its investment in the bank should be limited to the amount of its investment. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

A national bank's investment in an enterprise or entity must also satisfy the requirement that the investment have a beneficial connection to the bank's business, *i.e.,* be convenient or useful to the investing bank's business activities, and not constitute a mere passive investment unrelated to that bank's banking business. Twelve USC 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful."[10] OCC precedents on non-controlling investments by national banks

[8] W. Fletcher, *Cyclopedia of the Law of Private Corporations,* vol. 1, § 25 (rev. perm. ed. 1990).

[9] *See,* e.g.*, Starfish Condominium Association* v. *Yorkridge Service Corporation, Inc.,* 295 Md. 693, 458 A. 2d 805 (1983).

[10] *Arnold Tours* v. *Camp*, 472 F.2d 427, 432 (1st Circuit, 1972)

have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[11]

In this instance, [NB]'s ownership interest in the bank will be neither passive nor speculative, and this ownership interest will be convenient and useful for [NB]. The bank will provide deposit and loan services to [NB]. In addition, the bank will provide [NB] with an outlet for the buying and selling of loan participations and will also provide it with bank-related correspondent services permitted under 12 CFR 7.5007, *supra,* n. 7. Accordingly, the fourth standard is satisfied.

Conclusion

Based upon the information and representations you provided, and for the reasons discussed above, it is my opinion that [NB] may make a non-controlling equity investment in the bank, subject to the following conditions:

1) The bank will engage only in activities that are permissible for a national bank;

2) [NB] will divest its interest in the bank in the event that the bank engages in any activity that is inconsistent with condition 1;

3) [NB] will account for its investment in the bank under the equity or cost method of accounting; and

4) The bank will be subject to OCC supervision and examination, pursuant to 12 USC 1867(c).

These conditions are conditions imposed in writing by the OCC in connection with this opinion letter stating that [NB]'s investment in the bank is permissible under 12 USC 24(Seventh). As such, these conditions may be enforced in proceedings under applicable law.

If you have any questions, please contact Sue Auerbach, counsel, Bank Activities and Structure Division, at (202) 874–4662.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[11] *See,* e.g.*,* Interpretive Letter No. 943, *supra,* n. 3; Interpretive Letter No. 875, *reprinted in* [1999–2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–369 (October 31, 1999); Interpretive Letter No. 890, *supra,* n. 3; Interpretive Letter No. 543, *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991).

971—January 16, 2003

12 USC 24(7)

Reginald S. Evans, Esq.
Chief Counsel
Pennsylvania Department of Banking
333 Market Street, 16th Floor
Harrisburg, PA 17101–2290

Subject: [Operating subsidiary (op. sub.)]

Dear Mr. Evans:

This letter responds to your letter dated September 17, 2002, in which you ask a number of questions concerning the manner in which the Office of the Comptroller of the Currency (OCC) supervises operating subsidiaries of national banks. Many of these questions relate specifically to the OCC's supervision of [op. sub.], an operating subsidiary of [national bank (NB)], [city, state] (the bank). [Op. sub.] is incorporated in [state 2].

The tenor of your questions suggests that Pennsylvania has the authority to supervise the activities of [op. sub.] and, by implication, other operating subsidiaries of national banks. However, federal law and OCC regulations vest the OCC with exclusive "visitorial" powers over national banks and their operating subsidiaries.[1] Those powers include examining national banks, inspecting their books and records, regulating and supervising their activities pursuant to federal banking law, and enforcing compliance with federal or any applicable state law concerning those activities.[2] Federal law thus limits the extent to which any other governmental entity may exercise visitorial powers over national banks and their operating subsidiaries. Our response to your letter is provided to further the state's understanding of the OCC's supervision of national bank subsidiaries, but does not alter the jurisdiction established by federal law.

The OCC has urged state officials to contact the OCC if they have any information regarding allegations of violation of particular state laws by national banks or their subsidiaries.[3] In addition, any consumer complaints concerning any part of the operations of any national bank or operating subsidiary, including the bank and [op. sub.], are referred to the OCC Customer Assistance Group (CAG), which is located in Houston, Texas. The CAG investigates the complaint, with the assistance of other OCC units when appropriate,[4] and recommends appropriate action.

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[1] 12 USC 484(a); 12 CFR 7.4006.

[2] Advisory Letter No. 2002–9 (Nov. 25, 2002); 12 CFR 7.4000(a)(2).

[3] Advisory Letter No. 2002–9 at 4.

[4] For example, attorneys in the OCC's law department may provide legal advice if the matter involves questions of law.

The Nature and Scope of OCC Examinations

Many of your questions relate to the OCC's examination policies and procedures. For example, you ask questions concerning the scope of OCC examinations and the laws with which national banks and their operating subsidiaries must comply. The OCC conducts comprehensive examinations of a national bank's business, including its compliance with principles of safe and sound banking and its compliance with applicable laws. In addition, the OCC conducts targeted examinations that may cover one or more elements of a comprehensive examination, such as compliance with specific laws. The OCC has issued substantial guidance, which should provide more detailed answers to your questions. Copies of those materials are enclosed [a list of enclosures provided with original is supplied at the end of this letter].

National banks have express authority to create operating subsidiaries, which may engage in any activity permissible to the parent bank itself.[5] Generally, an operating subsidiary is a corporation or similar entity, in which a national bank owns more than 50 percent of the voting interest, or otherwise maintains a controlling interest.[6] Because the activities of an operating subsidiary are limited to activities in which the parent bank could engage directly, an operating subsidiary is in practice a separately incorporated division or department of the parent bank. Thus, the OCC's standards in examining [op. sub.] are the same standards that apply to OCC examinations of the bank. Consistent with the guidance enclosed with this letter, the OCC's examination of [op. sub.] addresses compliance with applicable laws, such as consumer protection laws, as well as compliance with standards of safe and sound banking.

[Op. sub.] engages in subprime mortgage lending. Because of the safety and soundness and compliance risks posed by these lending programs, the OCC has published additional guidance relating to subprime lending activities. The OCC relies on this guidance in examining [op. sub.] and other subprime lenders and, therefore, applies the same standards to [op. sub.] as it would to any national bank or operating subsidiary engaged in subprime lending activities. Copies of this guidance are enclosed for your reference.

In examining the lending function of a national bank or an operating subsidiary, the OCC typically reviews a sample of loans owned by the institution. This sample generally will include larger loans and loans that the institution has previously identified as problem loans. Through this review, the OCC will determine the quality of the loans (*e.g.*, the likelihood of repayment), the adequacy and completeness of the information concerning the loan and the borrower, and whether the lending function is being carried out in compliance with applicable laws. The OCC evaluates the adequacy of all elements of the institution's business, including earnings, assets, management, liquidity, sensitivity to market risk, and information systems, as well as specialty areas such as any trust operations that may exist. The examination process is intended to provide a high level of

[5] *See* generally 12 CFR 5.34.

[6] 12 CFR 5.34(e)(2).

assurance that each aspect of an institution's business is conducted on a safe and sound basis and in compliance with applicable laws.

[Op. sub.] generally does not retain the loans that it originates, but instead sells them in the secondary market shortly after origination. Based on those activities, the OCC reviews [op. sub.'s] lending function to determine compliance with all applicable laws and principles of safety and soundness.

Applicability of State Law

Some of your questions relate to the applicability of state (and federal) law to operating subsidiaries. For example, you ask whether state consumer protection laws apply to national bank operating subsidiaries. The OCC's regulations provide that state law applies to the operating subsidiary of a national bank "to the same extent that those laws apply to the parent national bank."[7] Questions about the applicability of state laws to national banks may be addressed in a variety of ways. In some cases, our regulations contain express provisions that address the applicability of state law to a national bank.[8] From time to time, the OCC also provides legal opinions that respond to specific requests and express our views about the applicability of particular state laws to national banks.[9] Preemption issues also may be resolved through litigation over the applicability of particular state laws to national banks.[10]

For example, courts have repeatedly recognized the essentially federal character of national banks,[11] and the Supreme Court has held that subjecting national banks' federally authorized activities to state regulation and supervision would conflict with their federally derived powers and with the purposes for which the national banking system was established.[12] In one such decision,

[7] 12 CFR 7.4006.

[8] *E.g.*, 12 CFR 7.5002(c) (furnishing products and services by electronic means), 34.4 (real estate lending), and 37.1(c) (debt cancellation contracts).

[9] *E.g.*, 66 Fed. Reg. 28,593 (May 23, 2001) (Michigan statute concerning motor vehicle loans); 65 Fed. Reg. 15,037 (March 20, 2000) (Pennsylvania statute concerning auctions and auctioneers).

[10] *The Bank of America* v. *City and County of San Francisco*, 309 F.3d 551 (9th Cir. 2002); *Bank One Utah, N.A.* v. *Guttau*, 109 F.3d 844 (8th Cir. 1999).

[11] *See, e.g., Davis* v. *Elmira Savings Bank*, 161 U.S. 275, 283 (1896) ("[n]ational banks are instrumentalities of the Federal government").

[12] *See Easton* v. *Iowa*, 188 U.S. 220, 229, 231–32 (1903), in which the Supreme Court explained:

> [Federal legislation concerning national banks] has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and numerous as the states. . . . [W]e are unable to perceive that Congress intended to leave the field open for the states to attempt to promote the welfare and stability of national banks by direct legislation. If they had such power it would have to be exercised and limited by their own discretion, and confusion would necessarily result from control possessed and exercised by two independent authorities.

See also Barnett Bank of Marion County, N.A. v. *Nelson*, 517 U.S. 25, 32 (1996) (the powers of national banks are "grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law").

the Court noted that national banks are "instrumentalities" of the federal government and stated that "any attempt by a State to define [the] duties [of a national bank] or control the conduct of [the] affairs [of the national bank] is void whenever it conflicts with the laws of the United States or frustrates the purposes of the national legislation or impairs the efficiency of the bank to discharge the duties for which it was created."[13]

Essential to the character of national banks and the national banking system is the uniform and consistent regulation of national banks by *federal* standards.[14] To that end, Congress vested in the OCC broad authority to regulate the conduct of national banks except when the authority to issue such regulations has been "expressly and exclusively" given to another federal regulatory agency. 12 USC 93a. State law could be applicable to national banks, however, in limited circumstances when it does not conflict or interfere with the national bank's exercise of its powers. Thus, for instance, one federal court recently noted that states retain some power to regulate national banks in areas such as "contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law."[15]

You also ask whether a litigant in a lawsuit against [op. sub.] could pierce the corporate veil to recover damages from the bank. This question would be more appropriately discussed in the context of litigation between [op. sub.] and a customer or other third party involving a specific factual situation. In general, though, mere ownership of a subsidiary corporation does not result in liability on the part of the parent for acts of its subsidiary.

OCC Supervision of [Op. Sub.]

The OCC examines national banks and their operating subsidiaries on a regular basis. Federal law requires that the OCC examine national banks, such as the bank, at least once every 12 months.[16] However, the OCC may examine an institution more frequently if warranted by the institution's asset size, condition, or other factors. For example, the largest national banks have on-site examination teams conducting continuous examinations. Thus, while it is impossible to predict the

[13] *First Nat'l Bank of San Jose* v. *California*, 262 U.S. 366, 368, 369 (1923). *See also Bank of America*, 309 F.3d at 561 (state attempts "to control the conduct of national banks are void if they conflict with federal law, frustrate the purposes of the National Bank Act, or impair the efficiency of national banks to discharge their duties").

[14] Such standards may be embodied explicitly in OCC regulations, or in other federal law, including various federal consumer protection laws, such as the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, and the Federal Trade Commission Act. *See* 15 USC 1601 *et seq.*; 12 USC 4301 *et seq.;* 15 USC 1693 *et seq.*; 12 USC 2601 *et seq.*; 15 USC 1691 *et seq.*; 15 USC 45. However, whether or not the OCC has specifically addressed a national bank activity in a regulation, all national bank operations must be conducted in a safe and sound manner, in accordance with the OCC's supervisory standards.

[15] *Bank of America*, 309 F.3d at 559.

[16] 12 USC 1820(d)(1). If a bank has less than $250,000,000 in assets and is in good condition, the OCC need only examine it at least once every 18 months. 12 USC 1820(d)(4).

exact timing of OCC examinations of [op. sub.] in the future, it appears very likely that the OCC will continue to conduct an examination of [op. sub.] at least every 12 months, consistent with the federal statutory schedule for examining the bank.

The OCC generally prepares letters transmitting the examination findings to [op. sub.] and the bank. Those letters are the equivalent of examination reports and, therefore, are considered confidential. Examination reports, along with other bank examination information, are exempt from disclosure under the Freedom of Information Act.[17] This information is also subject to a limited privilege from discovery in third-party litigation.[18] These protections reflect the sensitive nature of bank examination information and support the longstanding policy of the OCC not to provide examination reports to third parties. Typically, the OCC will make confidential bank examination information available to state bank regulatory agencies if they demonstrate a specific regulatory need for the examination information (*e.g.*, merger of a national bank into a state bank, where the state bank regulator must approve the transaction), and if the state agency has entered into an appropriate information sharing/confidentiality agreement with the OCC governing use of the information.

I hope the foregoing has been of assistance to you in understanding the nature of the OCC's supervision of [op. sub.]. If you have any questions concerning this letter, please contact Frederick Petrick, Counsel, Litigation Division, at (202) 874–5280, or Mary Ann Nash, Counsel, Legislative and Regulatory Activities Division, at (202) 874–5090.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[17] 5 USC 552(b)(8).

[18] *In re Subpoena Duces Tecum Served Upon the Comptroller of the Currency and the Secretary of the Board of Governors of the Federal Reserve System*, 967 F.2d 630 (D.C. Cir. 1992).

Enclosures

[List of enclosures provided with original letter]

BANK SAFETY AND SOUNDNESS SUPERVISION

***Comptroller's Handbook* booklets:**

"Allowance for Loan and Lease Losses" (June 1996)

"Bank Supervision Process" (April 1996)

"Community Bank Supervision" (August 2001)

"Community Reinvestment Act Examination Procedures" (May 1999)

"Examination Planning and Control" (July 1997)

"Insider Activities" (March 1995)

"Interest Rate Risk" (June 1997)

"Internal and External Audits" (July 2000)

"Internal Control" (January 2001)

"Introduction" (July 1994)

"Liquidity" (February 2001)

"Litigation and Other Legal Matters" (February 2000)

"Loan Portfolio Management" (April 1998)

"Management Information Systems" (May 1995)

"Mortgage Banking" (March 1996)

"Rating Credit Risk" (April 2001)

"Sampling Methodologies" (August 1998)

"FFIEC Information Systems Handbook" (January 1996)

OCC Advisory Letters:

OCC Advisory Letter 1997–8, "Allowance for Loan and Lease Losses"

OCC Advisory Letter 2000–9, "Third-Party Risk"

OCC Advisory Letter 2000–12, "Risk Management of Outsourcing Technology Services" (letter and FFIEC policy statement)

OCC Bulletins:

OCC Bulletin 1997–24, "Credit Scoring Models, Examination Guidance" (bulletin and examination guidance)

OCC Bulletin 1999–38, "Interagency Guidelines for Real Estate Lending Policies" (bulletin and interagency guidance)

OCC Bulletin 2000–20, "Uniform Retail Credit Classification and Account Management Policy" (bulletin and *Federal Register* notice)

OCC Bulletin 2001–47, "Third-Party Relationships—Risk Management Principles"

COMPLIANCE REGULATION AND EXAMINATION

"An Examiner's Guide to Consumer Compliance" [January 1993, out of print]

***Comptroller's Handbook* booklets:**

"Bank Secrecy Act/Anti-Money Laundering" (September 2000)

"Compliance Management System" (August 1996)

"Conflicts of Interest" (June 2000)

"Fair Credit Reporting" (October 1996)

"Fair Lending" (December 2000)

"Flood Disaster Protection" (May 1999)

"Home Mortgage Disclosure" (August 1996)

"Other Consumer Protection Laws and Regulations" (October 1996)

"Real Estate Settlement Procedures" (August 1996)

"Truth in Lending" (December 1996)

ADDITIONAL SUBPRIME LENDING GUIDANCE

OCC Bulletin 1999–10, "Subprime Lending Activities" (bulletin and interagency guidance).

OCC Bulletin 1999–15, "Subprime Lending—Risks and Rewards" (bulletin and subprime examination procedures)

OCC Bulletin 2001–6, "Subprime Lending—Expanded Guidance for Subprime Lending Programs" (bulletin and interagency guidance)

ADDITIONAL CONSUMER PROTECTION GUIDANCE

OCC Advisory Letter 1995–8, "Fair Lending (Credit Scoring—Age Implications)" [was incorporated into *Comptroller's Handbook* booklet, "Fair Lending," dated December 2000, also provided]

OCC Advisory Letter 2000–7, "Abusive Lending Practices"

"Assistance for Customers of National Banks" [brochure, no date]

OCC Bulletin 2000–3, "Consumer Credit Reporting Practices—Federal Financial Institutions Examinations Council Advisory Letter" (bulletin and FFIEC advisory letter)

972–August 12, 2003

12 CFR 4.31

Thomas R. Dyer, Esq.
Wyatt Tarrant & Combs, LLP
1715 Aaron Brenner Drive, Suite 800
Memphis, Tennessee 38120–4367

Subject: *Union Planters Bank, N.A.* v. *Continental Casualty, No. 02–2332–GV (W.D. Tenn.)*

Dear Mr. Dyer:

This acknowledges your telephone calls and your August 8 letter informing us, as required by Office of the Comptroller of the Currency ("OCC") regulations, 12 CFR 4.37(b)(3), that defendants in the above referenced litigation have filed a Motion to use certain confidential and privileged OCC documents stemming from an OCC examination of Union Planters Bank, N.A., Memphis, Tennessee. Your letter indicates that Union Planters inadvertently produced these documents to defendants, and the bank has requested their return. The documents contain the subjective analysis and recommendations of OCC examiners.

For the reasons below, the OCC, as the bank's federal regulator, is concerned about the defendants' Motion and the bank's inadvertent production, and we ask you to convey our concerns to the court.

First, examination reports prepared by OCC examiners on national banks are confidential in that they are expressly exempt from the mandatory disclosure provisions of the Freedom of Information Act by virtue of 5 USC 552(b)(8). These reports are also privileged under the bank examination privilege. As explained in detail in *In Re Subpoena Served Upon the Comptroller of the Currency,* 967 F.2d 630 (D.C. Circuit, 1992), the success of the OCC's regulation of banks is highly dependent on a candid flow of information between the bank and the OCC, and "These conditions simply could not be met as well if communications between the bank and its regulators were not privileged." 967 F.2d at 633–634. *See also In re Bankers Trust Co.,* 61 F.3d 465, 471 (6th Circuit, 1995) ("Thus, the privilege is designed to promote the effective functioning of an agency by allowing the agency and the regulated banks the opportunity to be forthright in all communications"). The bank examination privilege belongs to the OCC, *First Eastern Corp.* v. *Mainwaring,* 21 F.3d 465, 468 (D.C. Circuit, 1994), and the OCC has not waived the privilege in the above referenced litigation.

Second, although the bank is in lawful possession of the OCC examination report and other supervisory communications, the bank is barred by federal law from producing these documents without the OCC's approval. 12 CFR 4.37(b)(1). Bank supervisory materials are "non-public OCC information" and "the property of the Comptroller," and are "loaned to the bank . . . for its confidential use only." 12 CFR 4.32(b)(2). The OCC has not given Union Planters Bank permission to produce this material to others, and the OCC has not authorized any party to this litigation to use these confidential documents.

Third, the defendants have not exhausted their administrative remedies with the OCC. For private litigants like defendants here, the OCC and the other federal bank regulatory agencies (Federal Reserve Board, Federal Deposit Insurance Corporation ("FDIC") and Office of Thrift Supervision ("OTS")) have promulgated regulations allowing a party to apply to the agency for access to non-public information. *See* 12 CFR 4.31 et seq. Here, the proper course of action is for defendants to exhaust their administrative remedies by seeking the OCC's approval under 12 CFR 4.31 to use the documents. To do this, defendants should write the OCC's director of Litigation at the address in 12 CFR 4.34(a) and make the showings required by 12 CFR 4.33 (especially, showings as to relevance, availability of alternative evidence, and need). The OCC will then render a final agency decision that a federal court may review if called upon to do so. Indeed, this procedure is codified in OCC regulations:

> Without OCC approval, no person, national bank or other entity, including one in lawful possession of non-public OCC information under paragraph (b)(2) of this section, may disclose information covered by this subpart in any manner, except: (A) After the requester has sought the information from the OCC pursuant to the procedures set forth in this subpart; and (B) As ordered by a federal court in a judicial proceeding in which the OCC has had the opportunity to appear and oppose discovery.

12 CFR 4.37(b)(1). Since this procedure is available, the federal courts have required private litigants to use it in order to exhaust their administrative remedies.[1]

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[1] *Raffa* v. *Wachovia Corp*., 242 F.Supp.2d 1223 (U.S. District Court for the Middle District of Florida, 2002) (directing plaintiff shareholders to use OCC's administrative procedures for access to non-public OCC information); *American Save. Bank* v. *PaineWebber*, 210 F.R.D. 721, 722 (U.S. District Court for the District of Hawaii, 2001) (stating with reference to OTS regulations that "Courts, in construing regulations which control the release of official information, have held that such information should not be compelled to be produced in violation of these regulations"); *In Re First Chicago Shareholder Securities Litigation*, Civ. No. 00–C 67 (U.S. District Court for the Northern District of Illinois, November 20, 2001) (denying motion to compel bank to produce OCC examination reports while the OCC considers an administrative request); *U.S.* v. *Amico*, 2003 WL 1145426 (U.S. District Court for the Western District of New York, January 3, 2003) (quashing subpoena for OCC documents and directing defendant to exhaust administrative remedies); *Nat'l Union Fire Ins. Co.* v. *Midland Bancorp, Inc*., 159 F.R.D. 562, 571–72 (U.S. District Court for the District of Kansas, 1994) ("When federal agencies promulgate official regulations, setting forth procedures to obtain information otherwise exempt from disclosure, the party seeking it may obtain it, if at all, only after following those procedures"); *Golden Pacific Bancorp* v. *FDIC,* 1999 U.S. District Court, LEXIS 20303, 1999 WL 1332312 (District of New Jersey, November 10, 1999) (quashing subpoena for OCC employee's testimony for failure to exhaust administrative remedies); *Frick* v. *Austin Bank, N.A*., 1999 U.S. District Court LEXIS 11493 (Eastern District of Texas, June 25, 1999) (directing party to use the OCC's administrative process); *In re Adelbert A. Thompson*, No. 98–11253 (Bankr. D. Vt. Apr. 26, 1999) (denying motion for Rule 2004 examination and directing debtor to submit administrative request for examination report to the OCC).

Two decisions in the case of *Raffa* v. *Wachovia Corp., supra,* which involved a national bank's attempt to retrieve an inadvertently produced OCC examination report, support this result. In the first decision, the court ordered the party in possession of the OCC information to submit an administrative request to the OCC to use the information. 242 F. Supp. 2d 1223, 1225 (U.S. District Court for the Middle District of Florida, 2002). The party did so, the OCC denied the request in a final agency decision, the party sought review in the same court, and the court upheld the OCC's decision. *Raffa* v. *Wachovia Corp.,* 2003 WL 21517778 (U.S. District Court for the Middle District of Florida, May 15, 2003). This is the process envisioned in 12 CFR 4.37(b)(1) and endorsed by the federal courts, and defendants should follow it here.

I appreciate your conveying our concerns to the court. If the court schedules oral argument on the defendants' Motion, please inform me or Ford Barrett, assistant director of our Litigation Division, at (202) 874–5280, so that the OCC may be represented.

Raymond Natter
Deputy Chief Counsel

cc: Joe Dycus, Esq.
Assistant U. S. Attorney

973–August 12, 2003

12 USC 92a
12 CFR 9

John D. Lowery
Riddell Williams P.S.
1001 Fourth Avenue Plaza
Suite 4500
Seattle, Washington 98154–1065

Subject: Fiduciary Powers of U.S. Trust Company, N.A.

Dear Mr. Lowery:

By letter dated July 16, 2003, you have requested, on behalf of U.S. Trust Company, N.A. (the bank), a letter from the Office of the Comptroller of the Currency (OCC) confirming the authority of the bank to serve, in California, as indenture trustee for municipal bonds issued in the state of Washington. This letter replies to the three specific questions you have posed and confirms that the bank has that authority.

Background

The bank is a national bank that has been authorized by the OCC to exercise trust powers. You have informed us that the bank served as indenture trustee for bonds issued in October of 2000 by the Holmes Harbor Sewer District, a municipal water and sewer district organized and existing under the laws of the state of Washington ("HHSD"). Sometime in late 1999 or early 2000, HHSD decided to issue municipal bonds to finance the acquisition of land and construction of utility infrastructure in a utility local improvement district ("ULID") formed by HHSD and located in Everett, Washington, outside HHSD's geographic boundaries.

In connection with the issuance of the bonds, HHSD retained two law firms, one located in California and one in Washington, to act as bond counsel; both bond counsel also acted as special disclosure counsel to HHSD. HHSD also contracted with an underwriter, IBIS Securities (IBIS), for a negotiated underwriting; IBIS retained its own underwriter's counsel. These parties also drafted all disclosure documents for investors.

In mid September 2000 (approximately one month before the HHSD bonds were issued), U.S. Trust was approached by IBIS in California and asked to serve as indenture trustee for the HHSD bonds. U.S. Trust was provided with the opinion letters of two bond counsel stating that the ULID was validly formed, that the bonds were revenue bonds (it is undisputed that the issuer had authority under Washington law to appoint a private trustee if the bonds were revenue bonds), that HHSD had authority to issue the bonds, and that HHSD had authority to execute the indenture. U.S. Trust received these opinions prior to executing the indenture and relied on them in executing the indenture, as is the custom and practice of the industry. HHSD made similar representations in the Certificate of the Issuer executed at closing.

On October 26, 2000 (the date the bonds closed), the bank executed an indenture with HHSD (a customer located in the state of Washington). The indenture authorized the bank to conclusively rely on any certificate, opinion (including bond counsel opinions) or other document believed by it to be genuine and to have been signed or presented by the proper party, and provided that the bank undertook no responsibility with respect to any information, statement or recital in any official statement, offering memorandum or any other disclosure material prepared or distributed with respect to the bonds. The indenture also provided that all representations in the indenture were the statements of HHSD.

At all times prior to the bond issuance and while the bank was servicing the HHSD trust account, the bank's trust office was located in San Francisco. The bank did not at that time (and does not currently) maintain a trust office in Washington. The bank responded from its office in San Francisco to a request that the bank serve the customer located in Washington.

The bank asks the OCC to answer three specific questions, which are set forth, together with their answers, in the remainder of this letter.

Analysis

1. Are the bank's fiduciary trust powers and authority to act as trustee governed by federal law or by state law?

The bank's fiduciary powers are governed by federal law and derive from 12 USC 92a and Part 9 of the OCC's regulations. The statutory authority for national banks to exercise fiduciary powers is contained in 12 USC 92a. Section 92a permits national banks to exercise fiduciary powers with OCC approval,[1] and directs that the fiduciary powers available to a national bank are determined by reference to state law. Section 92a(a) provides:

> The Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

[1] *See* 12 CFR 5.26, as amended by 66 *Federal Register* 34792, 34797 (July 2, 2001) (licensing requirements for fiduciary powers).

> The grant of statutory authority in section 92a does not limit where a national bank may act in a fiduciary capacity. Accordingly, our regulations expressly provide that a national bank may act in a fiduciary capacity in any state.[2]

In addition, section 92a imposes no limitations on where the bank may market its services, where the bank's fiduciary customers may be located, or where property being administered is located. Once the state in which a national bank is acting in a fiduciary capacity is identified, the fiduciary services may be offered regardless of where the fiduciary customers reside or where property that is being administered is located. Our regulation codifies this conclusion, stating that while acting in a fiduciary capacity in one state, a national bank may market its fiduciary services to customers in other states.[3] In addition, a national bank may act as fiduciary for relationships that include property located in other states.[4]

2. Would California law or Washington law be the applicable state law incorporated into federal law for purposes of determining the fiduciary capacity in which the bank may act under 12 USC 92a for customers located in the state of Washington?

As we have described, a national bank looks to state law to determine which fiduciary capacities are permissible. For this purpose, the relevant law is the law of the state in which the national bank acts, or proposes to act, in a fiduciary capacity.[5]

Part 9 of the OCC's regulations also clarifies that the state in which a bank acts in a fiduciary capacity for any given fiduciary relationship is the state in which the bank performs the core fiduciary activities of accepting fiduciary appointments, executing documents that create the fiduciary relationship, or making decisions regarding the investment or distribution of fiduciary assets.[6] For each fiduciary relationship, a national bank will refer to only one state's laws for purposes of defining the extent of its fiduciary powers pursuant to section 92a.

With respect to its fiduciary relationship with HHSD, the bank acted in a fiduciary capacity in the state of California, since the core fiduciary activities of accepting the fiduciary appointment, ex-

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[2] 12 CFR 9.7(a). *Id*. For a discussion of the analysis on which section 9.7 is based, see 66 *Federal Register* 34792, 34794–96 (July 2, 2001) (preamble to final rule adopting section 9.7). *See also* OCC Interpretive Letter No. 695 (December 8, 1995) ("IL 695") (analyzing national banks' authority to engage in fiduciary activities in multiple states); OCC Interpretive Letter No. 872 (October 28, 1999) ("IL 872") (concluding that a national bank in Ohio may solicit and conduct a trust business in California and that state laws that purport to prohibit the bank from engaging in these activities were preempted).

[3] *Id.* at section 9.7(b).

[4] *Id.*

[5] *Id*. at section 9.7(d).

[6] *Id*. If, with respect to a particular fiduciary relationship, these core fiduciary activities take place in more than one state, then the state in which the bank acts in a fiduciary capacity will be the state that the bank designates from among those states.

ecuting the documents that created the fiduciary relationship, and making the decisions regarding the investment or distribution of fiduciary assets were all performed there. Based on the foregoing analysis, whenever the bank acts in a fiduciary capacity in California, the bank would look to the laws of that state to determine which fiduciary capacities it may engage in, and may then engage in any of these capacities for customers in other states. The fiduciary capacities permitted under the laws of other states where the bank's customers are located, including Washington state law in this instance, do not affect the fiduciary capacities in which the bank may act when it is acting in a fiduciary capacity in California.

3. Given that a state can regulate its own municipal instrumentalities and political subdivisions, did the bank nonetheless have full fiduciary trust powers and authority to act as trustee for customers located in any state (including, without limitation, Washington) if the bank was authorized by federal law to engage in fiduciary trust activities and assuming that the bank complied with the applicable state law of California as incorporated into federal law granting the bank such fiduciary trust powers and authority?

If the bank may act as an indenture trustee under section 92a, the bank is authorized to act as an indenture trustee on a multistate basis. As expressly provided in our regulation, the laws of any state other than California—including Washington—that purport to limit or establish preconditions on the exercise of that fiduciary power are not applicable to the bank.[7] A state's authority to regulate the instrumentalities of its own government (for example, by state laws restricting the types of trustees, or other fiduciaries, those state government instrumentalities may appoint), is a separate matter, wholly independent of, and not affecting, the fiduciary authorities granted to national banks as a matter of federal law. Thus, the federal authority of a national bank to act as a trustee (or to act in any other permissible fiduciary capacities) is not affected by such statutes.

We note that certain other provisions in section 92a expressly require the application of state law in certain areas affecting a national bank's exercise of fiduciary powers.[8] For instance, a state's laws governing certain operational requirements are made applicable to national banks by sections 92a(f), (g), and (i). Section 92a(c) grants state banking authorities limited access to OCC examination reports relating to national bank trust departments. However, as provided in our

[7] *Id.* at section 9.7(e). *See also* IL 872.

[8] It should be noted that some national banking laws, including section 92a, incorporate elements of state law and make them part of the federal law applicable to national banks. However, the determination of what elements of state law are incorporated is a question of federal law. Once it is determined, other parts of state law—even on the same subject matter—are not incorporated and so are subject to the usual national bank preemption analysis. *Cf. Independent Bankers Ass'n of America* v. *Clarke,* 917 F.2d 1126 (8th Circuit 1990); *Department of Banking & Consumer Finance* v. *Clarke*, 809 F.2d 266 (5th Circuit), *cert. denied*, 483 U.S. 1010 (1987). In these decisions, state laws that applied the state's commercial bank branching laws to national banks were found to conflict with the federal branching authority of the McFadden Act, even though the McFadden Act refers to state law. Similarly, section 92a refers to state law but does not include *all* state law governing fiduciary activities.

regulations,[9] in each case where section 92a applies state law to national banks, it is the law of the state where the national bank is acting in a fiduciary capacity—here, California law.

I trust that the foregoing is responsive to the questions you have asked. Please feel free to contact Andra Shuster, counsel, at (202) 874–4694 should you have further questions.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[9] 12 CFR 9.7(e)(1).

974–July 21, 2003

12 USC 85

Dear [ ]:

This is in response to your inquiry of June 10, 2003 on behalf of [ ] (the bank) and its operating subsidiaries, [OpSub1] and [OpSub2] ("the operating subsidiaries"). In that letter, you request confirmation that the operating subsidiaries may originate mortgage loans and charge and export interest, including fees that constitute interest as defined in 12 CFR 7.4001, as authorized by 12 USC 85 and applicable Indiana law to borrowers residing in all states and without regard to the site of the real property securing the loan. For the reasons described below, the operating subsidiaries may impose and export Indiana interest charges under the same terms and conditions applicable to the bank.

The bank has its main office in [State] and no branches in any other state. The operating subsidiaries are wholly owned by the bank. The operating subsidiaries originate first and subordinate secured mortgage loans in their own names on a nationwide basis secured by real property consisting of one- to four-family residential dwellings. You note that the operating subsidiaries are subject to examination and supervision by the OCC and operate in compliance with requirements and limitations imposed by section 85 and OCC regulations and interpretations regarding section 85. The bank seeks confirmation that it may establish, through the operating subsidiaries, nationwide lending programs with pricing policies consistent with the laws of the parent bank's home state, Indiana.

The operating subsidiaries are authorized operating subsidiaries of the bank, approved by the OCC under 12 CFR 5.34. As such their activities are subject to the same terms and conditions that apply to the bank. As stated in the relevant OCC regulations—

> *Examination and supervision.* An operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank.[1]

Elsewhere, our regulations specify that "[s]tate laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."[2] Legislation also recognizes the permissibility of national banks engaging in activities through operating subsidiaries. In the Gramm–Leach–Bliley Act, Congress expressly acknowledged that national banks may own subsidiaries that engage "solely in activities that national banks are permitted to engage in

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[1] 12 CFR 5.34(e)(3).

[2] 12 CFR 7.4006.

directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks."[3] Operating subsidiaries are often described as equivalent to a department or division of their parent bank, and our regulations ensure that operating subsidiaries will be subject to the same federal laws and standards that govern their parent bank, including any state laws and standards that are made applicable to the parent bank by federal law.[4]

One such law is section 85 governing the rate of interest a national bank may charge. Under section 85, the rate of interest a national bank is authorized to charge is based on the laws of the state in which the bank is located.[5] OCC regulations provide that:

> A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state.[6]

This "most favored lender" lender status permits a national bank to contract with borrowers in any state for interest at the maximum rate permitted by the law of the state in which the national bank is located. Generally, that is the state in which the main office of the national bank is located, and the bank may impose rates of interest without regard to the law of the state where the borrower resides.[7]

Accordingly, pursuant to 12 CFR 5.34(e)(3) and 7.4006, the amount of interest the operating subsidiaries may charge is governed by section 85 to the same extent as section 85 is applicable to its

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[3] Pub. L. No. 106–102, 121, 113 Stat. at 1378, *codified at* 12 USC 24a(g)(3).

[4] Letter from Charles F. Byrd, assistant director, Legal Advisory Services Division to (October 30, 1977), *reprinted in* [1978–1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,051 (national bank operating subsidiaries are in effect incorporated departments of the bank). *See also Wells Fargo* v. *Boutris,* No. Civ. S–03–0157, 2003 U.S. District Court WL 21277203 at *6 (Eastern District of California, May 9, 2003); (operating subsidiary is "treated as department or division of its parent bank for regulatory purposes"); *National City Bank of Indiana* v. *Burris,* No. Civ. S–03–0655 (Eastern District of California, July 2, 2003) (same).

[5] 12 USC 85.

[6] 12 CFR 7.4001(b).

[7] *Marquette National Bank of Minneapolis* v. *First of Omaha Service Corp,* 439 U.S. 299 (1978). Under certain circumstances, national banks with branches in more than one state may be required to impose interest rates permitted by the law of a state in which they have a branch. That would happen in circumstances where three functions—loan approval, communication of loan approval, and disbursal of loan proceeds—all occur in a branch or branches in the same branch state. OCC Interpretive Letter No. 822 (Feb. 17, 1998), *reprinted in* [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–265. Absent this set of circumstances, a national bank may impose rates permitted by the state where its main office is located. This issue does not arise with respect to the bank because it has no branches outside of Indiana.

parent bank.[8] Thus, the permissible rates of interest authorized for the operating subsidiaries are based on [State] law, as are the bank's.

I hope the foregoing is helpful in your analysis of your client's lending programs. Please do not hesitate to contact my office at (202) 874–5200; MaryAnn Nash, counsel, at (202) 874–5090; Jerome L. Edelstein, senior counsel, at (202) 874–5300; or Coreen Arnold, district counsel, at (312) 360–8805, if you have any questions or if you need any additional information.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[8] *See* OCC Interpretive Letter 954, December 16, 2002, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–479; OCC Interpretive Letter by Julie L. Williams, first senior deputy comptroller and chief counsel, to L. Richard Fischer (February 12, 2003) (both letters determining that an operating subsidiary of national bank could rely on section 85 to the same extent that the parent bank could rely on section 85). This position was first expressed by the OCC in a 1979 letter. *See* OCC Interpretive Letter by John Shockey, chief counsel (May 18, 1979). *See also Moss* v. *Southtrust Mobile Services, Inc*., No. CV–95–P–1647–W, 1995 U.S. District Court LEXIS 21770 (Northern District of Alabama, Sept. 22, 1995) (court concluded, without analysis, that section 85 applied to the subsidiary in question pursuant to 12 CFR 5.34 because it was an operating subsidiary of a national bank).

We also confirm your conclusion that, as to loans secured by first liens on residential property, section 85 provides national banks with an alternative source of interest rate authority from that provided by 12 USC 1735f–7a, which preempts state interest limitations on such loans. Section 1735f–7a, however, does not apply where a state has opted out of this federal preemption and it does not preempt state limits on prepayment fees and late charges. In adopting section 1735f–7a, however, Congress provided that, where that section and section 85 apply to the same loan or mortgage, the loan or mortgage may be made at the highest possible rate. 12 USC 1735f–7a note (Choice of Highest Applicable Interest Rate).