Quarterly Journal

Special Interest—On Preemption and Visitorial Powers

Special Interest— On Preemption and Visitorial Powers

The Federal Character of the National Bank Charter[1]

The OCC issued two regulations that reflect fundamental characteristics of the national banking system. The first clarifies what types of state laws apply to national banks, while the second clarifies issues related to the OCC's exclusive visitorial powers over national banks. As part of the rulemaking on the applicability of state laws to national banks, the OCC also established a strong standard to ensure that predatory lending does not gain a foothold in the national banking system. The OCC took this step despite widespread agreement that predatory lending remains a problem for unregulated financial institutions, rather than for regulated commercial banks.

In January 2004, the OCC published the following documents explaining the rulemaking on national bank preemption and the OCC's visitorial powers:

- News Release 2004–03
- Statement of Comptroller of the Currency John D. Hawke, Jr. Regarding the Issuance of Regulations Concerning Preemption and Visitorial Powers
- Preemption Final Rule
- Visitorial Powers Final Rule
- Questions and Answers on the Preemption Rulemaking
- Questions and Answers on the Visitorial Powers Rulemaking
- Two tables comparing OCC's preemption rules with those of the Office of Thrift Supervision and the National Credit Union Administration

[1]Also available on the OCC's public Web site at http://www.occ.treas.gov/newrules.htm.

NEWS RELEASE NR 2004-3

Contact: Robert M. Garsson
January 7, 2004
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OCC Issues Final Rules on National Bank Preemption and Visitorial Powers; Includes Strong Standard to Keep Predatory Lending Out of National Banks

WASHINGTON—The Office of the Comptroller of the Currency issued two final rules today that reflect the federal character of the national banking system. The regulations enhance the ability of national banks to plan their activities with predictability and to operate efficiently, subject to effective and efficient supervision.

The first rule codifies a series of court decisions and OCC interpretations, establishes symmetry with federal thrifts regarding the types of state laws that apply to national banks, and includes a strong anti-predatory lending standard. The second rule clarifies the scope of the OCC's visitorial authority under federal law.

The new rules respond to numerous questions the OCC has received in recent years about the extent to which state laws apply to national banks and the authority of state or other agencies to examine or take actions against national banks. National banks are already subject to a comprehensive set of federal requirements, and the overlay of multiple state law standards would impose unnecessary and excessively costly burdens.

"When national banks are unable to operate under uniform, consistent and predictable standards, their business suffers and so does the safety and soundness of the national banking system," said Comptroller of the Currency John D. Hawke, Jr. "The application of multiple and often unpredictable state laws interferes with their ability to plan and manage their business, as well as their ability to serve the people, the communities and the economy of the United States."

Mr. Hawke noted that national banks operate in an environment characterized by rapidly-evolving technology, a highly mobile customer base and credit markets that are national, if not international in scope. In that environment, the proliferation of state and local laws leads to higher costs that banks must either absorb themselves, pass on to their customers, or avoid by dropping products and reducing the availability of credit.

While states are free to pass laws governing the operation of the institutions they supervise and regulate, customers of national banks will continue to benefit from an array of consumer protections available through federal law, OCC regulations and the rigorous supervision of national banks and their subsidiaries by the OCC, the Comptroller added.

In the area of predatory lending, national bank customers would be protected by the comprehensive standard included in today's rulemaking. The standard, which applies to all consumer lending activities, codifies the OCC's pioneering approach to combating unfair and deceptive practices and bars loans that rely upon the foreclosure value of the collateral for repayment, a restriction that will prevent lenders from extending credit with an eye toward seizing a borrower's home.

"We have seen only isolated cases of abusive practices among national banks," Mr. Hawke added. "But when we have identified problems, we have taken quick and effective action. Our enforcement actions have resulted in the payment of hundreds of millions of dollars in restitution to national bank customers."

The Comptroller said that the OCC's anti-predatory lending standard is a preventive measure that is aimed at keeping abuses out of the national banking system.

"Predatory lending is a very significant problem in many American communities, but there is scant evidence that regulated banks are engaged in abusive or predatory practices," he said. "Our regulation will ensure that predatory lending does not gain a foothold in the national banking system."

The prohibition on basing loans on the foreclosure value of the borrower's collateral is grounded in safety and soundness principles. However, in response to comment letters noting that such practices are common in business lending and with some types of loans such as reverse mortgages, the OCC specified that the rule applies only to consumer loans and that loans could be based on collateral values if the borrower and lender agree that it is likely the collateral will be used to repay the debt.

While the OCC does not have legal authority to issue regulations defining particular acts or practices as unfair and deceptive practices under the Federal Trade Commission (FTC) Act, the agency does have the authority to take enforcement actions where a national bank is found to have engaged in unfair or deceptive practices. The rule thus specifically provides that national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the act. In recent years, the OCC has taken a series of enforcement actions based on Section 5 of the FTC Act.

The preemption rule deals with lending, deposit taking, and other national bank activities. OCC regulations already included a partial list of state laws that do not apply to national bank real estate lending activities, which are covered by a separate federal statute, 12 USC 371.

The preemption rule issued today builds on the current regulation by providing that state laws that "obstruct, impair, or condition" a national bank's powers in the areas of lending, deposit taking and other national bank operations are not applicable to national banks. The rule identifies additional specific types of state laws that apply to national banks and specific types of laws that do not apply.

Examples of laws that do not apply to national banks are those that regulate loan terms, require state licenses, or impose conditions on deposit or credit relationships. Laws that do not affect the manner or content of national bank activities, such as those dealing with contracts, torts, taxation, or zoning, are not preempted under the rule.

"Federal preemption is not a new idea," Mr. Hawke said. "Its roots lie in the Supremacy Clause of the Constitution, and the courts have repeatedly held that the states cannot restrict the federally-authorized activities of national banks."

The Comptroller noted that the list of preempted state laws is nearly identical to the list incorporated into the regulations of the Office of Thrift Supervision, the federal agency that supervises nationally chartered thrift institutions.

The visitorial powers rule clarifies two points concerning the OCC's existing regulation governing its exclusive power to supervise national banks. Under federal statute, "No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress. . . ."

The rule clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national bank activities authorized under federal law, but not to areas that have nothing to do with the business of banking, such as environmental laws and fire codes.

The regulation also clarifies that the exception for visitorial powers "vested in the courts of justice" pertains to the powers of the judiciary and does not grant state or other government authorities rights they do not otherwise possess to examine or supervise a national bank.

Under existing regulations that were not changed in today's rulemakings, both the visitorial powers rule and the preemption regulation apply to the operating subsidiaries of national banks. They do not apply to financial subsidiaries, nor do they authorize any new powers or activities, such as real estate brokerage.

The two regulations will take effect 30 days after publication in the *Federal Register.*

The two regulations and additional explanatory materials are available on the OCC's Internet site at: http://www.occ.treas.gov/newrules.htm [and are available here on the following pages.]

STATEMENT OF COMPTROLLER OF THE CURRENCY JOHN D. HAWKE, JR. REGARDING THE ISSUANCE OF REGULATIONS CONCERNING PREEMPTION AND VISITORIAL POWERS

January 7, 2004

Today the OCC is issuing two final regulations that concern fundamental characteristics of the national bank charter and fundamental responsibilities of the OCC. Both regulations are important to the future of the national banking system, and will enhance the ability of national banks to plan their activities with predictability and operate efficiently in the modern financial services marketplace, subject to effective and efficient supervision. Both also are solidly grounded in the long-established authority of national banks under federal law and the longstanding responsibilities of the OCC as their supervisor.

The first final regulation clarifies the extent to which the operations of national banks are subject to state laws. The rule identifies the types of state laws that are preempted by the federal powers of national banks under the National Bank Act, as well as various types of state laws that are not preempted. The types of laws that the regulation preempts—including laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses—create impediments to the ability of national banks to exercise powers that are granted under federal law. These laws create higher costs and operational burdens that the banks either must shoulder, or pass on to consumers, or that may have the practical effect of driving them out of certain businesses.

The preemption of state laws that limit the powers and activities of federally chartered banks is based on Constitutional principles that have been recognized from the earliest decades of our nation. In fact, the concept was first announced in the Supreme Court's *M'Cullough* v. *Maryland* decision in 1819, a case involving the federally chartered Second Bank of the United States. Precedents of the Supreme Court dating back to 1869 have addressed preemption in the context of national banks and have consistently and repeatedly recognized that national banks were designed to operate, throughout the nation, under uniform, federally set standards of banking operations. Today, as a result of technology and our mobile society, many aspects of the financial services business are unrelated to geography or jurisdictional boundaries, and efforts to apply restrictions and directives that differ based on a geographic source increase the costs of offering products or result in a reduction in their availability, or both. In this environment, the ability of national banks to operate under consistent, uniform national standards administered by the OCC will be a crucial factor in their business future.

Preemption has been a controversial subject of late, however, in large part because of concerns that preemption of state predatory lending laws will expose consumers to abusive and predatory lending practices. I have made clear on a number of occasions that predatory and abusive lending practices have no place in the national banking system, and we have no evidence that national banks (or their subsidiaries) are engaged in such practices to any discernible degree. Virtually all State Attorneys General have more than once expressed the view that information available to them does not show that banks and their subsidiaries are engaged in abusive or predatory lending practices. On those limited occasions where we have found national banks to be engaged in unacceptable practices, we have taken vigorous enforcement action. We have an array of supervisory measures and enforcement tools available and we are firmly committed to use them to keep such practices out of the national banking system.

To that end, we have taken the extra step of including in our new preemption regulation two new provisions to prevent abusive or predatory lending practices. These new provisions apply to all national banks (and their subsidiaries), wherever in the nation they are located. The regulation first provides that national banks may not make consumer loans based predominantly on the foreclosure or liquidation value of a borrower's collateral. This will target the most egregious aspect of predatory lending, where a lender extends credit, not based on a reasonable determination of a borrower's ability to repay, but on the lender's calculation of its ability to foreclose on and appropriate the borrower's accumulated equity in his or her home. This practice has particularly tragic results for minorities and the elderly and, as a result of our new regulation, is now specifically banned throughout the national banking system.

The regulation also recognizes that other practices also are associated with predatory lending. While we do not have authority under the Federal Trade Commission Act to adopt rules defining particular acts or practices as unfair or deceptive under that act, (since the act confers exclusive rulemaking authority on the Federal Reserve to define such practices by banks), we do have the authority to take enforcement action where we find unfair and deceptive practices. Our new regulation thus specifically provides that national banks shall not engage in unfair or deceptive practices within the meaning of section 5 of the FTC Act in connection with their lending activities.

The preemption standards in our new regulation are firmly grounded on standards announced by the U.S. Supreme Court in cases that trace back over 130 years, and our authority to adopt the regulation is solidly based on our statutes. Some critics of the regulation have claimed that we are using an incorrect preemption standard; this is simply not so, and the final regulation specifically—and meticulously—explains the sources of our authority to issue the regulation and the standards we use. It is relevant to note in that regard that the laws listed as preempted in our new regulation are virtually identical to those listed as preempted with respect to federal thrifts in existing regulations of the Office of Thrift Supervision.

Other critics have suggested that by codifying in a regulation the types of state laws that are, or are not, preempted as applied to national banks, that the OCC "will demolish" the dual banking system, or "deprive bankers of a choice of charters." Not only do these comments short-change the state banking systems, but the argument is fundamentally backwards. Distinctions between state and federal bank charters, powers, supervision, and regulation are not contrary to the dual banking system; they are the essence of it. These differences are what make the dual banking system dual. Clarification of how the federal powers of national banks preempt inconsistent state laws is entirely consistent with the distinctions that make the dual banking system dual.

The second regulation that we are issuing today concerns the OCC's exclusive "visitorial powers" with respect to national banks. "Visitorial powers" refers to the authority to examine, supervise and regulate the affairs of a corporate entity. Under the National Bank Act, the OCC has exclusive visitorial powers over national banks. In practice, this means that state officials are not authorized to inspect, examine or regulate national banks, except where another federal law authorizes them to do so. These provisions of the National Bank Act date from the earliest days of the national banking system. They are an integral part of the overall scheme of the national banking system and to the ability of national banks to operate efficiently today, because they help to assure that the business of banking conducted by national banks is subject to uniform, consistent standards and supervision, wherever national banks operate.

Our final rule here clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national bank activities authorized under federal law. In other words, we are the exclusive supervisor of a national bank's banking activities; we do not enforce fire codes, environmental laws, zoning ordinances, generally applicable criminal laws, and the like. The final rule also clarifies that the National Bank Act does not give state officials any authority, in addition to whatever they may otherwise have, to use the court system to exercise visitorial powers over national banks.

This rule also has provoked controversy. As with the preemption regulation, concerns have been expressed that the regulation will undermine the dual banking system, as well as the ability of the states to protect consumers. For the same reasons as I've described above, we think these regulations are fully consistent with the dual banking system. We also are committed to assuring that customers of national banks have strong consumer protections. We apply federal standards of consumer protection and uniform supervisory standards and have been proactive to assure that customers of national banks are not harmed by unfair, deceptive, abusive, or predatory practices. We also have offered to work cooperatively with the states and have encouraged the states to work with us to refer consumer complaints involving national banks to the OCC. This approach, with the OCC applying its resources to protect customers of national banks, and the states directing their efforts to state-supervised entities, would *maximize* overall the regulatory oversight and protection that consumers receive.

Preemption Final Rule

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Parts 7 and 34
[Docket No. 04–04]
RIN 1557–AC73
[Billing Code 4810–33–P]

Bank Activities and Operations; Real Estate Lending and Appraisals

AGENCY: Office of the Comptroller of the Currency, Treasury.
ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is publishing a final rule amending parts 7 and 34 of our regulations to add provisions clarifying the applicability of state law to national banks' operations. The provisions concerning preemption identify types of state laws that are preempted, as well as the types of state laws that generally are not preempted, with respect to national banks' lending, deposit-taking, and other operations. In tandem with these preemption provisions, we are also adopting supplemental anti-predatory lending standards governing national banks' lending activities.

EFFECTIVE DATE: February 12, 2004.

FOR FURTHER INFORMATION CONTACT: For questions concerning the final rule, contact Michele Meyer, Counsel, or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities Division, (202) 874–5090.

Supplementary Information:

I. Introduction

The OCC is adopting this final rule to specify the types of state laws that do not apply to national banks' lending and deposit taking activities *and* the types of state laws that generally *do* apply to national banks. Other state laws not specifically listed in this final rule also would be preempted under principles of preemption developed by the U.S. Supreme Court, if they obstruct, impair, or condition a national bank's exercise of its lending, deposit-taking, or other powers granted to it under federal law.

This final rule also contains a new provision prohibiting the making of any type of consumer loan based predominantly on the bank's realization of the foreclosure value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. (A consumer loan for this purpose is a loan made for personal, family, or household purposes). This anti-predatory lending standard applies uniformly to all consumer-lending activities conducted by national banks, wherever located. A second anti-predatory lending standard in the final rule further specifically prohibits national banks from engaging in practices that are unfair and deceptive under the Federal Trade Commission Act (FTC Act)[1] and regulations issued thereunder, in connection with all types of lending.

The provisions concerning preemption of state laws are contained in 12 CFR part 34, which governs national banks' real estate lending, and in three new sections to part 7 added by this final rule: § 7.4007 regarding deposit-taking activities; § 7.4008 regarding non-real-estate-lending activities; and § 7.4009 regarding the other federally authorized activities of national banks. The first anti-predatory-lending standard appears both in part 34, where it applies with respect to real estate consumer lending, and in part 7, with respect to other consumer lending. The provision prohibiting a national bank from engaging in unfair or deceptive practices within the meaning of section 5 of the FTC Act and regulations promulgated thereunder[2] similarly appears in both parts 34 and 7.

II. Description of Proposal

On August 5, 2003, the OCC published a notice of proposed rulemaking (NPRM or proposal) in the *Federal Register* (68 FR 46119) to amend parts 7 and 34 of our regulations to add provisions clarifying the applicability of state law to national banks. These provisions identified the types of state laws that are preempted, as well as the types of state laws that generally are not preempted, in the context of national bank lending, deposit-taking, and other federally authorized activities.

A. Proposed Revisions to Part 34—Real Estate Lending

Part 34 of our regulations implements 12 USC 371, which authorizes national banks to engage in real estate lending subject to "such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order." Prior to the adoption of this final rule, subpart A of part 34 explicitly preempted state laws concerning five enumerated areas with respect to national banks and their operating subsidiaries.[3] Those are state laws concerning the loan to value ratio; the schedule for the repayment of principal and interest; the term to maturity of the loan; the aggregate amount of funds that may be loaned upon the security of real estate; and the covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan. Section 34.4(b) stated that the OCC would apply recognized principles of federal preemption in considering whether state laws apply to other aspects of real estate lending by national banks.

[1] 15 USC 45(a)(1).

[2] 12 CFR part 227.

[3] Prior 12 CFR 34.1(b) and 34.4(a).

Pursuant to our authority under 12 USC 93a and 371, we proposed to amend § 34.4(a) and (b) to provide a more extensive enumeration of the types of state law restrictions and requirements that do, and do not, apply to the real estate lending activities of national banks. To the five types of state laws already listed in the regulations, proposed § 34.4(a) added a fuller, but non-exhaustive, list of the types of state laws that are preempted, many of which have already been found to be preempted by the federal courts or OCC opinions. As also explained in the preamble to the NPRM, consistent with the applicable federal judicial precedent, other types of state laws that wholly or partially obstruct the ability of national banks to fully exercise their real estate lending powers might be identified and, if so, preemption of those laws would be addressed by the OCC on a case-by-case basis.

We also noted in the preamble that the nature and scope of the statutory authority to set "requirements and restrictions" on national banks' real estate lending may enable the OCC to "occupy the field" of the regulation of those activities. We invited comment on whether our regulations, like those of the Office of Thrift Supervision (OTS),[4] should state explicitly that federal law occupies the field of real estate lending. We noted that such an occupation of the field necessarily would be applied in a manner consistent with other federal laws, such as the Truth-in-Lending Act (TILA)[5] and the Equal Credit Opportunity Act (ECOA).[6]

Under proposed § 34.4(b), certain types of state laws are not preempted and would apply to national banks to the extent that they do not significantly affect the real estate lending operations of national banks or are otherwise consistent with national banks' federal authority to engage in real estate lending.[7] These types of laws generally pertain to contracts, collection of debts, acquisition and transfer of property, taxation, zoning, crimes, torts, and homestead rights. In addition, any other law that the OCC determines to interfere to only an insignificant extent with national banks' lending authority or is otherwise consistent with national banks' authority to engage in real estate lending would not be preempted.

The proposal retained the general rule stated in § 34.3 that national banks may "make, arrange, purchase, or sell loans or extensions of credit, or interests therein, that are secured by liens on, or interests in, real estate, subject to terms, conditions, and limitations prescribed by the Comptroller of the Currency by regulation or order." That provision was unchanged, other than by designating it as paragraph (a).

[4] 12 CFR 560.2.

[5] 15 USC 1601 *et seq.*

[6] 15 USC 1691 *et seq.*

[7] Federal law may explicitly resolve the question of whether state laws apply to the activities of national banks. There are instances where federal law specifically incorporates state law standards, such as the fiduciary powers statute at 12 USC 92a(a). The language used in this final rule "[e]xcept where made applicable by Federal law" refers to this type of situatio

The proposal added a new paragraph (b), prescribing an explicit, safety and soundness-based anti-predatory lending standard to the general statement of authority concerning lending. Proposed § 34.3(b) prohibited a national bank from making a loan subject to 12 CFR part 34 based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources.

This standard augments the other standards that already apply to national bank real estate lending under federal laws. These other standards include those contained in the OCC's Advisory Letters on predatory lending;[8] section 5 of the FTC Act,[9] which makes unlawful "unfair or deceptive acts or practices" in interstate commerce; and many other federal laws that impose standards on lending practices.[10] The NPRM invited commenters to suggest other anti-predatory lending standards that would be appropriate to apply to national bank real estate lending activities.

As a matter of federal law, national bank operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent banks, except where federal law provides otherwise. *See* 12 CFR 5.34(e)(3) and 7.4006. *See also* 12 CFR 34.1(b) (real estate lending activities specifically). Thus, by virtue of regulations in existence prior to the proposal, the proposed changes to part 34, including the new anti-predatory lending standard, applied to both national banks and their operating subsidiaries.

B. Proposed Amendments to Part 7—Deposit-taking, Other Lending, and Bank Operations

The proposal also added three new sections to part 7: § 7.4007 regarding deposit-taking activities, § 7.4008 regarding non-real estate lending activities, and § 7.4009 regarding other national bank operations. The structure of the proposed amendments was the same for §§ 7.4007 and 7.4008 and was similar for § 7.4009. For §§ 7.4007 and 7.4008, the proposal first set out a statement of the authority to engage in the activity. Second, the proposal stated that state laws that obstruct, in whole or in part, a national bank's exercise of the federally authorized power in question are not applicable, and listed several types of state laws that are preempted. As with the list of preempted state laws set forth in the proposed amendments to part 34, this list reflects judicial precedents

[8] *See* OCC Advisory Letter 2003–2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices" (February 21, 2003) and OCC Advisory Letter 2003–3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans" (February 21, 2003). These documents are available on the OCC's Web site at http://www.occ.treas.gov/advlst03.htm.

[9] 15 USC 45(a)(1).

[10] There is an existing network of federal laws applicable to national banks that protect consumers in a variety of ways. In addition to TILA and ECOA, national banks are also subject to the standards contained in the Real Estate Settlement Procedures Act, 12 USC 2601 *et seq.,* the Fair Housing Act, 42 USC 3601 *et seq.,* the Home Mortgage Disclosure Act, 12 USC 2801 *et seq.,* the Fair Credit Reporting Act, 15 USC 1681 *et seq.,* the Truth in Savings Act, 12 USC 4301 *et seq.,* the Consumer Leasing Act, 15 USC 1667, and the Fair Debt Collection Practices Act, 15 USC 1692 *et seq.*

and OCC interpretations concerning the types of state laws that can obstruct the exercise of national banks' deposit-taking and non-real estate lending powers. Finally, the proposal listed several types of state laws that, as a general matter, are not preempted.

As with the proposed amendments to part 34, the proposed amendment to part 7 governing non-real estate lending included a safety and soundness-based anti-predatory lending standard. As proposed, § 7.4008(b) stated that a national bank shall not make a loan described in § 7.4008 based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources. The preamble to the NPRM pointed out that non-real estate lending also is subject to section 5 of the FTC Act.

For proposed § 7.4009, as with proposed §§ 7.4007 and 7.4008, the NPRM first stated that a national bank could exercise all powers authorized to it under federal law. To address questions about the extent to which state law may permissibly govern powers or activities that have not been addressed by federal court precedents or OCC opinions or orders, proposed new § 7.4009(b) provided that state laws do not apply to national banks if they obstruct, in whole or in part, a national bank's exercise of powers granted to it under federal law. Next, proposed § 7.4009(c) noted that the provisions of this section apply to any national bank power or aspect of a national bank's operation that is not otherwise covered by another OCC regulation that specifically addresses the applicability of state law. Finally, the proposal listed several types of state laws that, as a general matter, are not preempted.

As with the proposed changes to part 34, and for the same reasons, the proposal's changes to part 7 would be applicable to both national banks and their operating subsidiaries by virtue of an existing OCC regulation.

III. Overview of Comments

The OCC received approximately 2,600 comments, most of which came from the following groups:

- *Realtors.* The vast majority—approximately 85 percent—of the opposing comments came from realtors and others representing the real estate industry, who expressed identical concerns about the possibility that national banks' *financial subsidiaries* would be permitted to engage in real estate brokerage activities[11] and that, if that power were authorized, the proposal would permit them to do so without complying with state real estate brokerage licensing laws. This final rule will not have that result because it does

[11]Pursuant to procedures established by the Gramm–Leach–Bliley Act, Pub. L. 106–102, 113 Stat. 1338 (November 12, 1999), for determining that an activity is "financial in nature," and thus permissible for financial holding companies and financial subsidiaries, the Board and Treasury jointly published a proposal to determine that real estate brokerage is "financial in nature." *See* 66 FR 307 (January 3, 2001). No final action has been taken on the proposal.

not apply to the activities of national bank financial subsidiaries. Thus, should the Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Board) proposal to permit financial subsidiaries and financial holding companies to engage in real estate brokerage activities go forward, this final rule would not affect the application of state real estate licensing requirements to national bank financial subsidiaries.

Many realtor comments also raised arguments concerning the impact of this rulemaking on consumers and market competition and some argued that preemption of state licensing requirements related to real estate *lending* is inappropriate on the basis of field or conflict preemption. These issues also were raised by other commenters and are addressed in sections IV and VI of this preamble.

- *Community and consumer advocates.* In addition to the comments from realtors, the OCC received opposing comments from community and consumer advocates. These commenters argued that the OCC should not adopt further regulations preempting state law and, in particular, should not adopt in the final rule an "occupation of the field" preemption standard for national banks' real estate lending activities. The community and consumer advocates also asserted that the proposed "obstruct, in whole or in part" preemption standard is inconsistent with, and a lowering of, the preemption standards articulated by the U.S. Supreme Court. Whatever the standard, the community and consumer advocates expressed concern that preemption would allow national banks to escape some state tort, contract, debt collection, zoning, property transfer, and criminal laws, and would expose consumers to widespread predatory and abusive practices by national banks. These commenters asserted that the OCC's proposed anti-predatory lending standard is insufficient and urged the OCC to further strengthen consumer protections in parts 7 and 34, including prohibiting specific practices characterized as unfair or deceptive. These issues are addressed in sections IV and VI of this preamble.

- *State officials and members of Congress.* State banking regulators, the Conference of State Bank Supervisors (CSBS), the National Conference of State Legislators, individual state legislators, the National Association of Attorneys General (NAAG), and individual state attorneys general questioned the legal basis of the proposal and argued that the OCC lacks authority to adopt it. These commenters, like the community and consumer advocates, also challenged the OCC's authority to adopt in the final rule either a "field occupation" preemption standard or the proposed "obstruct, in whole or in part" standard. These commenters raised concerns about the effect of the proposal, if adopted, on the dual banking system, and its impact on what they assert is the states' authority to apply and enforce consumer protection laws against national banks, and particularly against operating subsidiaries. Several members of Congress submitted comments, or forwarded letters from constituents and state officials, that echoed these concerns. The arguments concerning the dual banking system are addressed in the discussion of Executive Order

13132 later in this preamble.[12] The remaining issues raised by the state commenters are addressed in sections IV and VI of this preamble.[13]

- *National banks and banking industry trade groups.* National banks, other financial institutions, and industry groups supported the proposal. Many of these commenters argued that Congress has occupied the fields of deposit-taking and lending in the context of national banks and urged the OCC to adopt a final rule reflecting an extensive occupation of the field approach. These commenters concluded that various provisions of the National Bank Act establish broad statutory authority for the activities and regulation of national banks, and that these provisions suggest strongly that Congress did in fact intend to occupy the fields in question. In addition to these express grants of authority, the commenters noted that national banks may, under 12 USC 24(Seventh), "exercise . . . all such incidental powers as shall be necessary to carry on the business of banking," and that this provision has been broadly construed by the Supreme Court.[14] These commenters concluded that this broad grant of federal powers, coupled with equally broad grants of rulemaking authority to the OCC,[15] effectively occupy the field of national bank regulation.

Many of the supporting commenters also urged the adoption of the proposal for the reasons set forth in its preamble. These commenters agreed with the OCC's assertion in the preamble that banks with customers in more than one state "face uncertain compliance risks and substantial additional compliance burdens and expense that, for practical purposes, materially impact their ability to offer particular products and services."[16] The commenters stated that, in effect, a national bank must often craft different products or services (with associated procedures and policies, and their attendant additional costs) for each state in which it does business, or elect not to provide all of its products or services (to the detriment of consumers) in one or more states. These commenters believe that the proposal, if adopted, would offer much-needed clarification of when state law does or does not apply to the activities of a national bank and its operating subsidiaries. Such clarity, these commenters argued, is critical to helping national banks maintain and expand provision of financial services. Without such

[12] *See also* OCC publication titled *National Banks and the Dual Banking System* (September 2003).

[13] *See also* Letter from John D. Hawke, Jr., Comptroller of the Currency, to Senator Paul S. Sarbanes (December 9, 2003), available on the OCC's Web site at http://www.occ.treas.gov/foia/SarbanesPreemptionletter.pdf; and identical letters sent to nine other senators; and Letters from John D. Hawke, Jr., Comptroller of the Currency, to Representatives Sue Kelly, Peter King, Carolyn B. Maloney, and Carolyn McCarthy (December 23, 2003).

[14] *See, e.g., Nationsbank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.,* 513 U.S. 251, 258 n.2 (1995) *(VALIC).*

[15] *See, e.g.,* 12 USC 93a.

[16] 68 FR *[Federal Register]* 46119, 46120.

clarity, these commenters assert, the burdens and costs, and uncertain liabilities arising under a myriad of state and local laws, are a significant diversion of the resources that national banks otherwise can use to provide services to customers nationwide, and a significant deterrent to their willingness and ability to offer certain products and services in certain markets. These issues are addressed in sections IV and VI of this preamble.

IV. Reason and Authority for the Regulations

A. The regulations are issued in furtherance of the OCC's responsibility to ensure that the national banking system is able to operate as authorized by Congress

As the courts have recognized, federal law authorizes the OCC to issue rules that preempt state law in furtherance of our responsibility to ensure that national banks are able to operate to the full extent authorized under federal law, notwithstanding inconsistent state restrictions, and in furtherance of their safe and sound operations.

Federal law is the exclusive source of all of national banks' powers and authorities. Key to these powers is the clause set forth at 12 USC 24(Seventh) that permits national banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking."

This flexible grant of authority furthers Congress's long-range goals in establishing the national banking system, including financing commerce, establishing private depositories, and generally supporting economic growth and development nationwide.[17] The achievement of these goals required national banks that are safe and sound and whose powers are dynamic and capable of evolving so that they can perform their intended roles. The broad grant of authority provided by 12 USC 24(Seventh), as well as the more targeted grants of authority provided by other statutes,[18] enable national banks to evolve their operations in order to meet the changing needs of our economy and individual consumers.[19]

The OCC is charged with the fundamental responsibility of ensuring that national banks operate on a safe and sound basis, and that they are able to do so, if they choose, to the full extent of their powers under federal law. This responsibility includes enabling the national banking system to

[17] For a more detailed discussion of Congress's purposes in establishing a national banking system that would operate to achieve these goals distinctly and separately from the existing system of state banks, *see* the preamble to the proposal, 68 FR 46119, 46120, and *National Banks and the Dual Banking System, supra* note 12.

[18] *See, e.g.,* 12 USC 92a (authorizing national banks to engage in fiduciary activities) and 371 (authorizing national banks to engage in real estate lending activities).

[19] The Supreme Court expressly affirmed the dynamic, evolutionary character of national bank powers in *VALIC,* in which it held that the "business of banking" is not limited to the powers enumerated in 12 USC 24(Seventh) and that the OCC has the discretion to authorize activities beyond those specifically enumerated in the statute. *See* 513 U.S. at 258 n.2.

operate as authorized by Congress, consistent with the essential character of a national banking system and without undue confinement of their powers. Federal law gives the OCC broad rule-making authority in order to fulfill these responsibilities. Under 12 USC 93a, the OCC is authorized "to prescribe rules and regulations to carry out the responsibilities of the office"[20] and, under 12 USC 371, to "prescribe by regulation or order" the "restrictions and requirements" on national banks' real estate lending power without state-imposed conditions.[21]

In recent years, the financial services marketplace has undergone profound changes. Markets for credit (both consumer and commercial), deposits, and many other financial products and services are now national, if not international, in scope. These changes are the result of a combination of factors, including technological innovations, the erosion of legal barriers, and an increasingly mobile society.

Technology has expanded the potential availability of credit and made possible virtually instantaneous credit decisions. Mortgage financing that once took weeks, for example, now can take only hours. Consumer credit can be obtained at the point of sale at retailers and even when buying a major item such as a car. Consumers can shop for investment products and deposits on-line. With respect to deposits, they can compare rates and duration of a variety of deposit products offered by financial institutions located far from where the consumer resides.

Changes in applicable law also have contributed to the expansion of markets for national banks and their operating subsidiaries. These changes have affected both the type of products that may be offered and the geographic region in which banks—large and small—may conduct business. As a result of these changes, banks may branch across state lines and offer a broader array of products than ever before. An even wider range of customers can be reached through the use of technology, including the Internet. Community national banks, as well as the largest national banks, use new technologies to expand their reach and service to customers.

Our modern society is also highly mobile. Forty million Americans move annually, according to a recent Congressional report issued in connection with enactment of the Fair and Accurate Credit Transactions Act of 2003.[22] And when they move, they often have the desire, if not the expectation, that the financial relationships and status they have established will be portable and will remain consistent.

These developments highlight the significance of being able to conduct a banking business pursuant to consistent, national standards, regardless of the location of a customer when he or she first becomes a bank customer or the location to which the customer may move *after* becoming a bank

[20] 12 USC 93a.

[21] 12 USC 371(a).

[22] *See* S. Rep. No. 108–166, at 10 (2003) (quoting the hearing testimony of Secretary of the Treasury Snow).

customer. They also accentuate the costs and interference that diverse and potentially conflicting state and local laws have on the ability of national banks to operate under the powers of their federal charter. For national banks, moreover, the ability to operate under uniform standards of operation and supervision is fundamental to the character of their national charter.[23] When national banks are unable to operate under national standards, it also implicates the role and responsibilities of the OCC.

These concerns have been exacerbated recently, by increasing efforts by states and localities to apply state and local laws to bank activities. As we have learned from our experience supervising national banks, from the inquiries received by the OCC's law department, by the extent of litigation in recent years over these state efforts, and by the comments we received on the proposal, national banks' ability to conduct operations to the full extent authorized by federal law has been curtailed as a result.

Commenters noted that the variety of state and local laws that have been enacted in recent years—including laws regulating fees, disclosures, conditions on lending, and licensing—have created higher costs and increased operational challenges.[24] Other commenters noted the proliferation of state and local anti-predatory lending laws and the impact that those laws are having on lending in the affected jurisdictions. As a result, national banks must either absorb the costs, pass the costs on to consumers, or eliminate various products from jurisdictions where the costs are prohibitive. Commenters noted that this result is reached even in situations where a bank concludes that a law is preempted, simply so that the bank may avoid litigation costs or anticipated reputational injury.

As previously noted, the elimination of legal and other barriers to interstate banking and interstate financial service operations has led a number of banking organizations to operate, in multi-state metropolitan statistical areas, and on a multi-state or nationwide basis, exacerbating the impact of the overlay of state and local standards and requirements on top of the federal standards and OCC supervisory requirements already applicable to national bank operations. When these multi-jurisdictional banking organizations are subject to regulation by each individual state or municipality in which they conduct operations, the problems noted earlier are compounded.

[23] As we explained last year in the preamble to our amendments to part 7 concerning national banks' electronic activities, "freedom from State control over a national bank's powers protects national banks from conflicting local laws unrelated to the purpose of providing the uniform, nationwide banking system that Congress intended." 67 FR 34992, 34997 (May 17, 2002).

[24] Illustrative of comments along these lines were those of banks who noted that various state laws would result in the following costs: (a) approximately $44 million in start-up costs incurred by six banks as a result of a recently enacted California law mandating a minimum payment warning; (b) 250 programming days required to change one of several computer systems that needed to be changed to comply with anti-predatory lending laws enacted in three states and the District of Columbia; and (c) $7.1 million in costs a bank would incur as a result of complying with mandated annual statements to credit card customers.

Even the efforts of a single state to regulate the operations of a national bank operating only within that state can have a detrimental effect on that bank's operations and consumers. As we explained in our recent preemption determination and order responding to National City Bank's inquiry concerning the Georgia Fair Lending Act (GFLA),[25] the GFLA caused secondary market participants to cease purchasing certain Georgia mortgages and many mortgage lenders to stop making mortgage loans in Georgia. National banks have also been forced to withdraw from some products and markets in other states as a result of the impact of state and local restrictions on their activities.

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, which negatively affects their safety and soundness. The application of multiple, often unpredictable, different state or local restrictions and requirements prevents them from operating in the manner authorized under federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential exposure. In some cases, this deters them from making certain products available in certain jurisdictions.[26]

The OCC therefore is issuing this final rule in furtherance of its responsibility to enable national banks to operate to the full extent of their powers under federal law, without interference from inconsistent state laws, consistent with the national character of the national banking system, and in furtherance of their safe and sound operations. The final rule does not entail any new powers for national banks or any expansion of their existing powers. Rather, we intend only to ensure the soundness and efficiency of national banks' operations by making clear the standards under which they do business.

B. Pursuant to 12 USC 93a and 371, the OCC may adopt regulations that preempt state law

The OCC has ample authority to provide, by regulation, that types of state laws are not applicable to national banks. As mentioned earlier, 12 USC 93a grants the OCC comprehensive rulemaking authority to further its responsibilities, stating that—

> Except to the extent that authority to issue such rules and regulations has been expressly and

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[25] See 68 FR 46264 (August 5, 2003).

[26] As was recently observed by Federal Reserve Board Chairman Alan Greenspan (in the context of amendments to the Fair Credit Reporting Act), "[l]imits on the flow of information among financial market participants, *or increased costs resulting from restrictions that differ based on geography, may lead to an increase in the price or a reduction in the availability of credit,* as well as a reduction in the optimal sharing of risk and reward." Letter of February 28, 2003, from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to The Honorable Ruben Hinojosa (emphasis added).

> exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office. . . .[27]

This language is significantly broader than that customarily used to convey rulemaking authority to an agency, which is typically focused on a particular statute. This was recognized, some 20 years ago, by the United States Court of Appeals for the D.C. Circuit in its decision confirming that 12 USC 93a authorizes the OCC to issue regulations preempting state law. In *Conference of State Bank Supervisors* v. *Conover,*[28] the Conference of State Bank Supervisors (CSBS) sought to overturn a district court decision upholding OCC regulations that provided flexibility regarding the terms on which national banks may make or purchase adjustable rate mortgages (ARMs) and that preempted inconsistent state laws. The regulations provided generally that national banks may make or purchase ARMs without regard to state law limitations. The district court granted the OCC's motion for summary judgment on the ground that the regulations were within the scope of the OCC's rulemaking powers granted by Congress.

On appeal, the CSBS asserted that 12 USC 93a grants the OCC authority to issue only "housekeeping" procedural regulations. In support of this argument, the CSBS cited a remark from the legislative history of 12 USC 93a by Senator Proxmire that 12 USC 93a "carries with it no new authority to confer on national banks powers which they do not have under existing law." CSBS also cited a statement in the conference report that 12 USC 93a "carries no authority [enabling the Comptroller] to permit otherwise impermissible activities *of national banks* with specific reference to the provisions of the McFadden Act and the Glass–Steagall Act."[29]

The Court of Appeals rejected the CSBS's contentions concerning the proper interpretation of 12 USC 93a. The Court of Appeals explained first that the challenged regulations (like this final rule) did not confer any new powers on national banks. Moreover,

> [t]hat the Comptroller also saw fit to preempt those state laws that conflict with his responsibility to ensure the safety and soundness of the national banking system, *see* 12 USC § 481, does not constitute an expansion of the powers of national *banks.*[30]

Nor did the Court of Appeals find support for the CSBS's position in the conference report:

> as the "specific reference" to the McFadden and Glass–Steagall Acts indicates, the "impermissible activities" which the Comptroller is not empowered to permit are activities that are impermissible under federal, not state, law.[31]

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[27] 12 USC 93a.

[28] 710 F.2d 878 (D.C. Cir. 1983).

[29] *Id.* at 885 (emphasis in original).

[30] *Id.* (emphasis in original).

[31] *Id.*

The court summarized its rationale for holding that 12 USC 93a authorized the OCC to issue the challenged regulations by saying:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. *So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state laws.*[32]

The authority under 12 USC 93a described by the court in *CSBS* v. *Conover* thus amply supports the adoption of regulations providing that specified types of state laws purporting to govern as applied to national banks' lending and deposit-taking activities are preempted.

Under 12 USC 371, the OCC has the additional and specific authority to provide that the specified types of laws relating to national banks' real estate lending activities are preempted. As we have described and as recognized in *CSBS* v. *Conover,*[33] 12 USC 371 grants the OCC unique rule-making authority with regard to national banks' real estate lending activities. That section states:

> [a]ny national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.[34]

The language and history of 12 USC 371 confirm the real estate lending powers of national banks and that only the OCC—subject to other applicable federal law—and not the states may impose restrictions or requirements on national banks' exercise of those powers. The federal powers conferred by 12 USC 371 are subject *only* "to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."[35] Thus, the exercise of the powers granted by 12 USC 371 is not conditioned on compliance with

[32] *Id.* at 878 (emphasis added).

[33] In *CSBS* v. *Conover,* the court also held that the authority conferred by 12 USC 371, as the statute read at the time relevant to the court's decision, conferred authority upon the OCC to issue the preemptive regulations challenged in that case. The version of section 371 considered by the court authorized national banks to make real estate loans "subject to such terms, conditions, and limitations" as prescribed by the Comptroller by order, rule or regulations. The court said that the "restrictions and requirements" language contained in the statute today was "not substantially different" from the language that it was considering in that case. *Id.* at 884.

[34] 12 USC 371(a).

[35] *Id.* As noted *supra* at note 7, federal legislation occasionally provides that national banks shall conduct certain activities subject to state law standards. For example, national banks conduct insurance sales, solicitation, and cross–marketing activities subject to certain types of state restrictions expressly set out in the Gramm–Leach–Bliley Act. *See* 15 USC 6701(d)(2)(B). There is no similar federal legislation subjecting national banks' real estate lending activities to state law standards.

any state requirement, and state laws that attempt to confine or restrain national banks' real estate lending activities are inconsistent with national banks' real estate lending powers under 12 USC 371.

This conclusion is consistent with the fact that national bank real estate lending authority has been extensively regulated at the *federal* level since the power first was codified. Beginning with the enactment of the Federal Reserve Act of 1913,[36] national banks' real estate lending authority has been governed by the express terms of 12 USC 371. As originally enacted in 1913, section 371 contained a limited grant of authority to national banks to lend on the security of "improved and unencumbered farm land, situated within its Federal Reserve district."[37] In addition to the geographic limits inherent in this authorization, the Federal Reserve Act also imposed limits on the term and amount of each loan as well as an aggregate lending limit. Over the years, 12 USC 371 was repeatedly amended to broaden the types of real estate loans national banks were permitted to make, to expand geographic limits, and to modify loan term limits and per-loan and aggregate lending limits.

In 1982, Congress removed these "rigid statutory limitations"[38] in favor of a broad provision that is very similar to the current law and that authorized national banks to "make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation."[39] The purpose of the 1982 amendment was "to provide national banks with the ability to engage in more creative and flexible financing, and to become stronger participants in the home financing market."[40] In 1991, Congress removed the term "rule" from this phrase and enacted an additional requirement, codified at 12 USC 1828(o), that national banks (and other insured depository institutions) conduct real estate lending pursuant to uniform standards adopted at the federal level by regulation of the OCC and the other federal banking agencies.[41]

Thus, the history of national banks' real estate lending activities under 12 USC 371 is one of extensive Congressional involvement gradually giving way to a streamlined approach in which Congress has delegated broad rulemaking authority to the Comptroller. The two versions of 12 USC 371—namely, the lengthy and prescriptive approach prior to 1982 and the more recent

[36] Federal Reserve Act, December 23, 1913, ch. 6, 38 Stat. 251, as amended.

[37] *Id.* Section 24, 38 Stat. 273.

[38] S. Rep. No. 97–536, at 27 (1982).

[39] Garn–St. Germain Depository Institutions Act of 1982, Pub. L. 97–320, section 403, 96 Stat. 1469, 1510–11 (1982).

[40] S. Rep. No. 97–536, at 27 (1982).

[41] *See* section 304 of the Federal Deposit Insurance Corporation Improvement Act, codified at 12 USC 1828(o). These standards governing national banks' real estate lending are set forth in Subpart D of 12 CFR part 34.

statement of broad authority qualified only by reference to federal law—may be seen as evolving articulations of the same idea.

C. The preemption standard applied in this final rule is entirely consistent with the standards articulated by the Supreme Court

State laws are preempted by federal law, and thus rendered invalid with respect to national banks, by operation of the Supremacy Clause of the U.S. Constitution.[42] The Supreme Court has identified three ways in which this may occur. First, Congress can adopt express language setting forth the existence and scope of preemption.[43] Second, Congress can adopt a framework for regulation that "occupies the field" and leaves no room for states to adopt supplemental laws.[44] Third, preemption may be found when state law actually conflicts with federal law. Conflict will be found when either: (i) compliance with both laws is a "physical impossibility;"[45] or (ii) when the state law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[46]

In *Barnett Bank of Marion County* v. *Nelson,*[47] the Supreme Court articulated preemption standards used by the Supreme Court in the national bank context to determine, under the Supremacy Clause of the U.S. Constitution, whether federal law conflicts with state law such that the state law is preempted. As observed by the Supreme Court in *Barnett,* a state law will be preempted if it conflicts with the exercise of a national bank's federally authorized powers.

The Supreme Court noted in *Barnett* the many formulations of the conflicts standard. The Court stated:

> In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers. *See, e.g., Anderson Nat. Bank* v. *Luckett,* 321 U.S. 233, 247–252 (1944) (state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights

[42] "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Constitution VI, cl. 2.

[43] *See Jones* v. *Rath Packing Co.,* 430 U.S. 519, 525 (1977).

[44] *See Rice* v. *Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947).

[45] *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 143 (1963).

[46] *Hines* v. *Davidowitz,* 312 U.S. 52, 67 (1941); *Barnett Bank of Marion County, N.A.* v. *Nelson,* 517 U.S. 25, 31 (1996) (quoting *Hines).*

[47] 517 U.S. 25 (1996).

> and privileges of national banks"); *McClellan* v. *Chipman,* 164 U.S. 347, 358 (1896) (application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not "destro[y] or hampe[r]" national banks' functions); *National Bank* v. *Commonwealth,* 76 U.S. (9 Wall.) 353, 362 (1869) (national banks subject to state law that does not "interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the Federal] Government").[48]

The variety of formulations quoted by the Court—"unlawfully encroach," "hamper," "interfere with or impair national banks' efficiency"—defeats any suggestion that any one phrase constitutes the exclusive standard for preemption. As the Supreme Court explained in *Hines* v. *Davidowitz:*[49]

> There is not—and from the very nature of the problem there cannot be—any rigid formula or rule which can be used as a universal pattern to determine the meaning and purpose of every act of Congress. This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference. *But none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula.* Our primary function is to determine whether, under the circumstances of this particular case, [the state law at issue] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.[50]

Thus, in *Hines,* the Court recognized that the Supremacy Clause principles of preemption can be articulated in a wide variety of formulations that do not yield substantively different legal results. The variation among formulations that carry different linguistic connotations does not produce different legal outcomes.

We have adopted in this final rule a statement of preemption principles that is consistent with the various formulations noted earlier. The phrasing used in the final rule—"obstruct,[51] impair,[52] or condition"[53]—differs somewhat from what we proposed. This standard conveys the same sub-

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[48] *Id.* at 33–34. Certain commenters cite *Nat'l Bank* v. *Commonwealth* for the proposition that national banks are subject to state law. These commenters, however, omit the important caveat, quoted by the *Barnett* Court, that state law applies only where it does not "interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the federal] Government."

[49] 312 U.S. 52 (1941).

[50] *Id.* at 67 (emphasis added) (citations omitted).

[51] See *Hines,* 312 U.S. at 76.

[52] *See Nat'l Bank* v. *Commonwealth,* 76 U.S. at 362; *Davis* v. *Elmira Savings Bank,* 161 U.S. 275, 283 (1896); *McClellan,* 164 U.S. at 357.

[53] *See Barnett,* 517 U.S. at 34; *Franklin Nat'l Bank of Franklin Square* v. *New York,* 347 U.S. 373, 375–79 (1954).

stantive point as the proposed standard, however; that is, that state laws do not apply to national banks if they impermissibly contain a bank's exercise of a federally authorized power. The words of the final rule, which are drawn directly from applicable Supreme Court precedents, better convey the range of effects on national bank powers that the Court has found to be impermissible. The OCC intends this phrase as the distillation of the various preemption constructs articulated by the Supreme Court, as recognized in *Hines* and *Barnett,* and not as a replacement construct that is in any way inconsistent with those standards.

In describing the proposal, we invited comment on whether it would be appropriate to assert occupation of the entire field of real estate lending. Some commenters strongly urged that we do so, and that we go beyond real estate lending to cover other lending and deposit-taking activities as well. Upon further consideration of this issue and careful review of comments submitted pertaining to this point, we have concluded, as the Supreme Court recognized in *Hines* and reaffirmed in *Barnett,* that the effect of labeling of this nature is largely immaterial in the present circumstances. Thus, we decline to adopt the suggestion of these commenters that we declare that these regulations "occupy the field" of national banks' real estate lending, other lending, and deposit-taking activities. We rely on our authority under both 12 USC 93a and 371, and to the extent that an issue arises concerning the application of a state law not specifically addressed in the final regulation, we retain the ability to address those questions through interpretation of the regulation, issuance of orders pursuant to our authority under 12 USC 371, or, if warranted by the significance of the issue, by rulemaking to amend the regulation.

V. Description of the Final Rule

A. Amendments to Part 34.

1. § 34.3(a). The final rule retains the statement of national banks' real estate lending authority, now designated as § 34.3(a), that national banks may "make, arrange, purchase, or sell loans or extensions of credit, or interests therein, that are secured by liens on, or interests in, real estate (real estate loans), subject to 12 USC 1828(o) and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."

2. § 34.3(b). New § 34.3(b) adds an explicit safety and soundness-derived anti-predatory lending standard to the general statement of authority concerning lending. Many bank commenters voiced concern that the proposed anti-predatory lending standard, by prohibiting a national bank from making a loan based predominantly on the foreclosure value of a borrower's collateral without regard to the borrower's repayment ability, would also prohibit a national bank from engaging in legitimate, non-predatory lending activities. These commenters noted that reverse mortgage, small business, and high net worth loans are often made based on the value of the collateral.

We have revised the anti-predatory lending standard in the final rule to clarify that it applies to consumer loans only, (i.e., loans for personal, family, or household purposes), and to clarify that it is intended to prevent borrowers from being unwittingly placed in a situation where repayment is unlikely without the lender seizing the collateral. Where the bargain agreed to by a borrower and a lender involves an understanding by the borrower that it is likely or expected that the collateral will be used to repay the debt, such as with a reverse mortgage, it clearly is not objectionable that the collateral will then be used in such a manner. Moreover, the final rule's anti-predatory lending standard is not intended to apply to business lending or to situations where a borrower's net worth would support the loan under customary underwriting standards.

Thus, we have revised the anti-predatory lending standard so that it focuses on consumer loans and permits a national bank to use a variety of reasonable methods to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors.

Several commenters urged the OCC to expressly affirm that a national bank's lending practices must be conducted in conformance with section 5 of the FTC Act, which makes unlawful "unfair or deceptive acts or practices" in interstate commerce,[54] and regulations promulgated thereunder. As discussed in more detail in section VI of this preamble, the OCC has taken actions against national banks under the FTC Act where the OCC believed they were engaged in unfair or deceptive practices. As demonstrated by these actions, the OCC recognizes the importance of national banks and their operating subsidiaries acting in conformance with the standards contained in section 5 of the FTC Act. We therefore agree that an express reference to those standards in our regulation would be appropriate and have added it to the final rules.[55]

3. State laws that are preempted (§ 34.4(a)). Pursuant to 12 USC 93a and 371, the final rule amends § 34.4(a) to add to the existing regulatory list of types of state law restrictions and requirements that are not applicable to national banks. This list, promulgated under our authority "to prescribe rules and regulations to carry out the responsibilities of the office" and to prescribe the types of restrictions and requirements to which national banks' real estate lending activities shall be subject, reflects our experience with types of state laws that can materially affect and confine—and thus are inconsistent with—the exercise of national banks' real estate lending powers.[56]

[54] 15 USC 45(a)(1).

[55] It is important to note here that we lack the authority to do what some commenters essentially urged, namely, to specify by regulation that particular practices, such as loan "flipping" or "equity stripping," are unfair or deceptive. While we have the ability to take enforcement actions against national banks if they engage in unfair or deceptive practices under section 5 of the FTC Act, the OCC does not have rulemaking authority to define specific practices as unfair or deceptive under section 5. *See* 15 USC 57a(f).

[56] As we noted in our discussion of this list in the preamble to the proposal, the "OCC and Federal courts have thus far concluded that a wide variety of state laws are preempted, either because the state laws fit within the express preemption provisions of an OCC regulation or because the laws conflict with a Federal power vested in national banks." *See* 68 FR 46119, 46122–46123. The list is also substantially identical to the types of laws specified in a comparable regulation of the OTS. *See* 12 CFR 560.2(b).

The final rule revises slightly the introductory clause used in proposed § 34.4(a) in order to conform this section more closely to the amended sections of part 7 discussed later in this preamble. Thus, the final rule provides: "Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its federally authorized real estate lending powers do not apply to national banks." The final rule then expands the current list of the types of state law restrictions and requirements that are not applicable to national banks.

Many of the supporting commenters requested that the final rule clarify the extent to which particular state or local laws that were not included in the proposal are preempted. For example, these commenters suggested that the final rule address particular state laws imposing various limitations on mortgage underwriting and servicing.

We decline to address most of these suggestions with the level of specificity requested by the commenters. Identifying state laws in a more generic way avoids the impression that the regulations only cover state laws that appear on the list. The list of the types of preempted state laws is not intended to be exhaustive, and we retain the ability to address other types of state laws by order on a case-by-case basis, as appropriate, to make determinations whether they are preempted under the applicable standards.[57]

4. State laws that are not preempted (§ 34.4(b)). Section 34.4(b) also provides that certain types of state laws are not preempted and would apply to national banks to the extent that they are consistent with national banks' federal authority to engage in real estate lending because their effect on the real estate lending operations of national banks is only incidental. These types of laws generally pertain to contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, torts,[58] and homestead rights. In addition, any other law the effect of which is incidental to national banks' lending authority or otherwise consistent with national banks' authority to engage in real estate lending would not be preempted.[59] In general, these would be laws that do not attempt to regulate the manner or content of national banks' real estate lending, but that instead form the legal infrastructure that makes it practicable to exercise a permissible federal power.

[57] *See, e.g.,* OCC Determination and Order concerning the Georgia Fair Lending Act, *supra* footnote 25.

[58] *See Bank of America* v. *City & County of San Francisco,* 309 F.3d 551, 559 (9th Cir. 2002).

[59] The label a state attaches to its laws will not affect the analysis of whether that law is preempted. For instance, laws related to the transfer of real property may contain provisions that give borrowers the right to "cure" a default upon acceleration of a loan if the lender has not foreclosed on the property securing the loan. Viewed one way, this could be seen as part of the state laws governing foreclosure, which historically have been within a state's purview. However, as we concluded in the OCC Determination and Order concerning the GFLA, to the extent that this type of law limits the ability of a national bank to adjust the terms of a particular class of loans once there has been a default, it would be a state law limitation "concerning . . . (2) The schedule for the repayment of principal and interest; [or] (3) The term to maturity of the loan. . . ." 12 CFR 34.4(a). In such a situation, we would be governed by the effect of the state statute.

One category of state law included in the proposed list of state laws generally not preempted was "debt collection." Consistent with Supreme Court precedents addressing this type of state law,[60] we have revised the language of the final rule to refer to national banks' "right to collect debts."

B. Amendments to Part 7—Deposit-taking, Other Consumer Lending, and National Bank Operations.

The final rule adds three new sections to part 7: § 7.4007 regarding deposit-taking activities, § 7.4008 regarding non-real estate lending activities, and § 7.4009 regarding national bank operations. The structure of the amendments is the same for §§ 7.4007 and 7.4008 and is similar for § 7.4009.

For § 7.4007, the final rule first sets out a statement of the authority to engage in the activity. Second, the final rule notes that state laws that obstruct, impair, or condition a national bank's ability to fully exercise the power in question are not applicable, and lists several types of state laws that are preempted. Types of state laws that are generally preempted under § 7.4007 include state requirements concerning abandoned and dormant accounts, checking accounts, disclosure requirements, funds availability, savings account orders of withdrawal, state licensing or registration requirements, and special purpose savings services. Finally, the final rule lists types of state laws that, as a general matter, are not preempted. Examples of these laws include state laws concerning contract, rights to collect debt, tort, zoning, and property transfers. These lists are not intended to be exhaustive, and the OCC retains the ability to address other types of state laws on a case-by-case basis to make preemption determinations under the applicable standards.

For § 7.4008, the final rule also sets out a statement of the authority to engage in the activity (non-real estate lending), notes that state laws that obstruct, impair, or condition a national bank's ability to fully exercise this power are not applicable, and lists several types of state laws that are, or are not, preempted. Section 7.4008 also includes a safety and soundness-based anti-predatory lending standard. Final § 7.4008(b) states that "[a] national bank shall not make a consumer loan subject to this § 7.4008 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors." Separately, § 7.4008(c) also includes a statement that a national bank shall not engage in unfair or deceptive practices within

[60] *See, e.g., Nat'l Bank* v. *Commonwealth,* 76 U.S. at 362 (national banks "are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, *their right to collect their debts,* and their liability to be sued for debts, are all based on State law.") (emphasis added); *see also McClellan,*164 U.S. at 356–57 (quoting *Nat'l Bank* v. *Commonwealth).*

the meaning of section 5 of the FTC Act and regulations promulgated thereunder in connection with making non-real estate related loans. The standards set forth in § 7.4008(b) and (c), plus an array of federal consumer protection standards,[61] ensure that national banks are subject to consistent and uniform federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety and soundness-based criteria for their lending activities.

In § 7.4009, the final rule first states that national banks may exercise all powers authorized to them under federal law.[62] Second, the final rule states that except as otherwise made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its authorized powers do not apply to the national bank.[63] Finally, the final rule lists several types of state laws that, as a general matter, are *not* preempted. For the reasons outlined earlier in the discussion of the amendments to 12 CFR part 34, the reference to debt collection laws has been revised to refer to state laws concerning national banks' "rights to collect debts."

The OCC's regulations adopted in this final rule address the applicability of state law with respect to a number of specific types of activities. The question may persist, however, about the extent to which state law may permissibly govern powers or activities that have not been addressed by federal court precedents or OCC opinions or orders. Accordingly, as noted earlier, new § 7.4009 provides that state laws do not apply to national banks if they obstruct, impair, or condition a national bank's ability to fully exercise the powers authorized to it under federal law, including the content of those activities and the manner in which and standards whereby they are conducted.

As explained previously, in some circumstances, of course, federal law directs the application of state standards to a national bank. The wording of § 7.4009 reflects that a federal statute may require the application of state law,[64] or it may incorporate—or "federalize"—state standards.[65]

[61] *See supra* note 10.

[62] As noted in the proposal, the OTS has issued a regulation providing generally that state laws purporting to address the operations of federal savings associations are preempted. *See* 12 CFR 545.2. The extent of federal regulation and supervision of federal savings associations under the Home Owners' Loan Act is substantially the same as for national banks under the national banking laws, a fact that warrants similar conclusions about the applicability of state laws to the conduct of the federally authorized activities of both types of entities. *Compare, e.g.,* 12 USC 1464(a) (OTS authorities with respect to the organization, incorporation, examination, operation, regulation, and chartering of federal savings associations) *with* 12 USC 21 (organization and formation of national banking associations), 12 USC 481 (OCC authority to examine national banks and their affiliates), 12 USC 484 (OCC's exclusive visitorial authority), and 12 USC 93a (OCC authority to issue regulations).

[63] As noted previously, the final rule makes changes to the introductory clause concerning the applicability of state law in 12 CFR 34.4(a), 7.4007(b), 7.4008(d), and 7.4009(b) to make the language of these sections more consistent with each other.

[64] *See, e.g.,* 15 USC 6711 (insurance activities of national banks are "functionally regulated" by the states, subject to the provisions on the operation of state law contained in section 104 of the Gramm–Leach–Bliley Act).

[65] *See, e.g.,* 12 USC 92a (permissible fiduciary activities for national banks determined by reference to state law).

In those circumstances, the state standard obviously applies. State law may also apply if it only incidentally affects a national bank's federally authorized powers or if it is otherwise consistent with national banks' uniquely federal status. Like the other provisions of this final rule, § 7.4009 recognizes the potential applicability of state law in these circumstances. This approach is consistent with the Supreme Court's observation that national banks "are governed in their daily course of business far more by the laws of the state than of the nation."[66] However, as noted previously, these types of laws typically do not regulate the manner or content of the business of banking authorized for national banks, but rather establish the legal infrastructure that makes practicable the conduct of that business.

C. Application of amendments to operating subsidiaries

As a matter of federal law, national bank operating subsidiaries conduct their activities under a federal license, subject to the same terms and conditions as apply to the parent banks, except where federal law provides otherwise. *See* 12 CFR 5.34 and 7.4006. *See also* 12 CFR 34.1(b) (real estate activities specifically).[67] Thus, by virtue of preexisting OCC regulations, the changes to parts 7 and 34, including the new anti-predatory lending standards applicable to lending activities, apply to both national banks and their operating subsidiaries. The final rule makes no change to these existing provisions.

VI. The OCC's Commitment to Fair Treatment of National Bank Customers and High Standards of National Bank Operations

The OCC shares the view of the commenters that predatory and abusive lending practices are inconsistent with national objectives of encouraging home ownership and community revitalization, and can be devastating to individuals, families, and communities. We will not tolerate such practices by national banks and their operating subsidiaries. Our Advisory Letters on predatory lending,[68] our pioneering enforcement positions resulting in substantial restitution to affected consumers, and the anti-predatory lending standards adopted in this final rule reflect our commitment that national banks operate pursuant to high standards of integrity in all respects. The provisions of this final rule, clarifying that certain state laws are not applicable to national banks' operations, do not undermine the application of these standards to all national banks, for the protection of all national bank customers—wherever they are located.

Advisory Letters 2003–2, which addresses loan originations, and 2003–3, which addresses loan purchases and the use of third party loan brokers, contain the most comprehensive supervisory

[66] *Nat'l Bank* v. *Commonwealth,* 76 U.S. at 362 (holding that shares held by shareholders of a national bank were lawfully subject to state taxation).

[67] For a detailed discussion of this issue, *see* the OCC's visitorial powers rulemaking also published today in the *Federal Register.*

[68] *See supra* note 8.

standards ever published by any federal financial regulatory agency to address predatory and abusive lending practices and detail steps for national banks to take to ensure that they do not engage in such practices. As explained in the Advisory Letters, if the OCC has evidence that a national bank has engaged in abusive lending practices, we will review those practices not only to determine whether they violate specific provisions of law such as the Homeowners Equity Protection Act of 1994 (HOEPA), the Fair Housing Act, or the Equal Credit Opportunity Act, but also to determine whether they involve unfair or deceptive practices that violate the FTC Act. Indeed, several practices that we identify as abusive in our Advisory Letters—such as equity stripping, loan flipping, and the refinancing of special subsidized mortgage loans that originally contained terms favorable to the borrower—generally can be found to be unfair or deceptive practices that violate the FTC Act.

Moreover, our enforcement record, including the OCC's pioneering actions using the FTC Act to address consumer abuses that were not specifically prohibited by regulation, demonstrates our commitment to keeping abusive practices out of the national banking system. For example, *In the Matter of Providian Nat'l Bank, Tilton, New Hampshire,*[69] pursuant to the FTC Act, the OCC required payment by a national bank to consumers in excess of $300 million and imposed numerous conditions on the conduct of future business. Since the Providian settlement in 2000, the OCC has taken action under the FTC Act to address unfair or deceptive practices and consumer harm involving five other national banks.[70]

Most recently, on November 7, 2003, the OCC entered into a consent order with Clear Lake National Bank that requires the bank to reimburse fees and interest charged to consumers in a series of abusive home equity loans. More than $100,000 will be paid to 30 or more borrowers. This is the first case brought by a federal regulator under the FTC Act that cites the unfair nature of the terms of the loan. The OCC also found that the loans violated HOEPA, the Truth in Lending Act, and Real Estate Settlement Procedures Act.[71]

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[69] Enforcement Action 2000–53 (June 28, 2000), *available at* the OCC's Web site in the "Popular FOIA Requests" section at http://www.occ.treas.gov/foia/foiadocs.htm.

[70] *See In the Matter of First Consumers National Bank, Beaverton, Oregon,* Enforcement Action 2003–100 (required restitution of annual fees and overlimit fees for credit cards); *In the Matter of Household Bank (SB), N.A., Las Vegas, Nevada,* Enforcement Action 2003–17 (required restitution regarding private label credit cards); *In the Matter of First National Bank in Brookings, Brookings, South Dakota,* Enforcement Action 2003–1 (required restitution regarding credit cards); *In the Matter of First National Bank of Marin, Las Vegas, Nevada,* Enforcement Action 2001–97 (restitution regarding credit cards); and *In the Matter of Direct Merchants Credit Card Bank, N.A., Scottsdale, Arizona,* Enforcement Action 2001–24 (restitution regarding credit cards). These orders can be found on the OCC's Web site within the "Popular FOIA Requests" section at http://www.occ.treas.gov/foia/foiadocs.htm.

[71] *See In the Matter of Clear Lake National Bank, San Antonio, Texas,* Enforcement Action 2003–135 (November 7, 2003), available at http://www.occ.treas.gov/FTP/EAs/ea2003–135.pdf. We believe these enforcement actions, which have generated hundreds of millions of dollars for consumers in restitution, also demonstrate that the OCC has the resources to enforce applicable laws. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, in an action brought by Arizona against a national bank, among others, the restitution and remedial action ordered by the OCC in that matter against the bank was "comprehensive and significantly broader in scope that that available through

The OCC also has moved aggressively against national banks engaged in payday lending programs that involved consumer abuses. Specifically, we concluded four enforcement actions against national banks that had entered into contracts with payday lenders for loan originations, and in each case ordered the bank to terminate the relationship with the payday lender.[72]

Other than these isolated incidences of abusive practices that have triggered the OCC's aggressive supervisory response, evidence that national banks are engaged in predatory lending practices is scant. Based on the absence of such information—from third parties, our consumer complaint database, and our supervisory process—we have no reason to believe that such practices are occurring in the national banking system to any significant degree. Although several of the commenters suggested this conclusion is implausible given the significant share of the lending market occupied by national banks, this observation is consistent with an extensive study of predatory lending conducted by the Department of Housing and Urban Development (HUD) and the Treasury Department,[73] and even with comments submitted in connection with an OTS rulemaking concerning preemption of state lending standards by *46* state Attorneys General.

Less than one year ago, nearly two dozen state Attorneys General signed a brief in litigation that reached the same conclusion. That case involved a revised regulation issued by the Office of Thrift Supervision to implement the Alternative Mortgage Transaction Parity Act (AMTPA). The revised regulation seeks to distinguish between federally supervised thrift institutions and non-bank mortgage lenders and makes non-bank mortgage lenders subject to state law restrictions on

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[the] state court proceedings." *State of Arizona* v. *Hispanic Air Conditioning and Heating, Inc.,* CV 2000–003625, Ruling at 27, Conclusions of Law, paragraph 50 (August 25, 2003).

[72] *See In the Matter of Peoples National Bank, Paris, Texas,* Enforcement Action 2003–2; *In the Matter of First National Bank in Brookings, Brookings, South Dakota,* Enforcement Action 2003–1; *In the Matter of Goleta National Bank, Goleta, California,* Enforcement Action 2002–93; and *In the Matter of Eagle National Bank, Upper Darby, Pennsylvania,* Enforcement Action 2001–104. These orders can also be found on the OCC's Web site within the "Popular FOIA Requests" section at http://www.occ.treas.gov/foia/foiadocs.htm.

[73] A Treasury–HUD joint report issued in 2000 found that predatory lending practices in the subprime market are less likely to occur in lending by—

> banks, thrifts, and credit unions that are subject to extensive oversight and regulation. . . . The subprime mortgage and finance companies that dominate mortgage lending in many low–income and minority communities, while subject to the same consumer protection laws, are not subject to as much federal oversight as their prime market counterparts—who are largely federally supervised banks, thrifts, and credit unions. The absence of such accountability may create an environment where predatory practices flourish because they are unlikely to be detected.

Departments of Housing and Urban Development and the Treasury, "Curbing Predatory Home Mortgage Lending: A Joint Report" 17–18 (June 2000), *available at* http://www.treas.gov/press/releases/report3076.htm.

In addition, the report found that a significant source of abusive lending practices is non–regulated mortgage brokers and similar intermediaries who, because they "do not actually take on the credit risk of making the loan, . . . may be less concerned about the loan's ultimate repayment, and more concerned with the fee income they earn from the transaction." *Id.* at 40.

prepayment penalties and late fees. In *supporting* the OTS's decision to retain preemption of state laws for supervised depository institutions their subsidiaries but *not* for unsupervised housing creditors, the state Attorneys General stated:

> Based on consumer complaints received, as well as investigations and enforcement actions undertaken by the Attorneys General, predatory lending abuses are largely confined to the subprime mortgage lending market and to *non-depository institutions. Almost all of the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries.*[74]

It is relevant for purposes of this final rule that the preemption regulations adopted by the OCC are substantially identical to the preemption regulations of the OTS that have been applicable to federal thrifts for a number of years. It does not appear from public commentary—nor have the state officials indicated—that OTS preemption regulations have undermined the protection of customers of federal thrifts. In their brief in the OTS litigation described above, the state Attorneys General referenced "the burdens of federal supervision," in concluding that there "clearly is a substantial basis for OTS's distinction"[75] between its supervised institutions and state housing creditors.

These considerations are equally applicable in the context of national banks, and were recognized, *again,* by all 50 state Attorneys General, in their comment letter to the OCC on this very regulation, which stated:

> It is true that most complaints and state enforcement actions involving mortgage lending practices have not been directed at banks. However, most major subprime mortgage lenders are now subsidiaries of bank holding companies, *(although not direct bank operating subsidiaries).*[76]

The OCC is firmly committed to assuring that abusive practices—whether in connection with mortgage lending or other national bank activities—continue to have no place in the national banking system.

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[74] Brief for Amicus Curiae State Attorneys General, *Nat'l. Home Equity Mortgage Ass'n.* v. *OTS,* Civil Action No. 02–2506 (GK) (D.D.C.) at 10–11 (emphasis added).

[75] *Id.* at 10.

[76] National Association of Attorneys General comment letter on the proposal at 10 (October 6, 2003) (emphasis added).

VII. Regulatory Analysis

Community Development and Regulatory Improvement (CDRI) Act Delayed Effective Date

This final rule takes effect 30 days after the date of its publication in the *Federal Register,* consistent with the delayed effective date requirement of the Administrative Procedure Act. *See* 5. USC 553(d). Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act), 12 USC 4802(b), provides that regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions may not take effect before the first day of the quarter following publication unless the agency finds that there is good cause to make the rule effective at an earlier date. The regulations in this final rule require national banks to adhere to explicit safety and soundness-based anti-predatory lending standards. These standards prohibit national banks from engaging in certain harmful lending practices, thereby benefiting consumers. The final rule imposes no additional reporting, disclosure, or other requirements on national banks. Accordingly, in order for the benefits to become available as soon as possible, the OCC finds that there is good cause to dispense with the requirements of the CDRI Act.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 USC 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. Accordingly, a regulatory flexibility analysis is not needed. The amendments to the regulations identify the types of state laws that are preempted, as well as the types of state laws that generally are not preempted, in the context of national bank lending, deposit-taking, and other activities. These amendments simply provide the OCC's analysis and do not impose any new requirements or burdens. As such, they will not result in any adverse economic impact.

Executive Order 12866

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

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104–4 (2 USC 1532) (Unfunded Mandates Act), requires that an 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 an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a 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, this rulemaking is not subject to section 202 of the Unfunded Mandates Act.

Executive Order 13132 ["Federalism"]

Executive Order 13132, titled "Federalism," (Order) requires federal agencies, including the OCC, to certify their compliance with that Order when they transmit to the Office of Management and Budget 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 consultation requirements with state and local officials; requires publication in the preamble of a federalism summary impact statement; and requires the OCC to make available to the Director of the Office of Management and Budget any written communications submitted by state and local officials. By the terms of the Order, these requirements apply to the extent that they are practicable and permitted by law and, to that extent, must be satisfied before the OCC promulgates a final regulation.

In the proposal, we noted that the regulation may have federalism implications. Therefore, in formulating the proposal and the final rule, the OCC has adhered to the fundamental federalism principles and the federalism policymaking criteria. Moreover, the OCC has satisfied the requirements set forth in the Order for regulations that have federalism implications and preempt state law. The steps taken to comply with these requirements are set forth below.

- *Consultation.* The Order requires that, to the extent practicable and permitted by law, no agency shall promulgate any regulation that has federalism implications and that preempts state law unless, prior to the formal promulgation of the regulation, the agency consults with state and local officials early in the process of developing the proposal. We have consulted with state and local officials on the issues addressed herein through the rulemaking process. Following the publication of the proposal, representatives from the Conference of State Bank Supervisors (CSBS) met with the OCC to clarify their understanding of the proposal and, subsequently, the CSBS submitted a detailed comment letter regarding the proposal. As mentioned previously, additional comments were also submitted on the proposal by other state and local officials and state banking regulators. Pursuant to the Order, we will make these comments available to the Director of the OMB. Subsequent, public statements by representatives of the CSBS have restated their concerns, and CSBS representatives have further discussed these concerns with the OCC on several additional occasions.

In addition to consultation, the Order requires a federalism summary impact statement that addresses the following:

- *Nature of concerns expressed.* The Order requires a summary of the nature of the concerns of the state and local officials and the agency's position supporting the need to issue the regulation. The nature of the state and local official commenters' concerns and the OCC's position supporting the need to issue the regulation are set forth in the preamble, but may be summarized as follows. Broadly speaking, the states disagree with our interpretation of the applicable law, they are concerned about the impact the rule will have on the dual banking system, and they are concerned about the ability of the OCC to protect consumers adequately.

- *Extent to which the concerns have been addressed.* The Order requires a statement of the extent to which the concerns of state and local officials have been met.

  a. There is fundamental disagreement between state and local officials and the OCC regarding preemption in the national bank context. For the reasons set forth in the materials that precede this federalism impact statement, we believe that this final rule is necessary to enable national banks to operate to the full extent of their powers under federal law, and without interference from inconsistent state laws; consistent with the national character of the national banks; and in furtherance of their safe and sound operations. We also believe that this final rule has ample support in statute and judicial precedent. The concerns of the state and local officials could only be fully met if the OCC were to take a position that is contrary to federal law and judicial precedent. Nevertheless, to respond to some of the issues raised, the language in this final regulation has been refined, and this preamble further explains the standards used to determine when preemption occurs and the criteria for when state laws generally would *not* be preempted.

  b. Similarly, we fundamentally disagree with the state and local officials about whether this final rule will undermine the dual banking system. As discussed in the OCC's visitorial powers rulemaking also published today in the *Federal Register,* differences in national and state bank powers and in the supervision and regulation of national and state banks are not inconsistent with the dual banking system; rather, they are the defining characteristics of it. The dual banking system is universally understood to refer to the chartering and supervision of state-chartered banks by state authorities and the chartering and supervision of national banks by federal authority, the OCC. Thus, we believe that the final rule preserves, rather than undermines, the dual banking system.

  c. Finally, we stand ready to work with the states in the enforcement of applicable laws. The OCC has extended invitations to state Attorneys General and state banking departments to enter into discussions that would lead to a memorandum of understanding about the handling of consumer complaints and the pursuit of remedies, and we remain eager to do so. Moreover, as discussed in the preamble, we believe the OCC has the resources to enforce applicable laws, as is evidenced by the enforcement actions that have generated hundreds of millions of dollars for consumers in restitution, that have required national banks to disassociate themselves from payday lenders, and that have ordered national banks to stop abusive practices. Thus, the OCC has ample legal authority and resources to ensure that consumers are adequately protected.

List of Subjects

12 CFR Part 7

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

12 CFR Part 34

Mortgages, National banks, Real estate appraisals, Real estate lending standards, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth in the preamble, parts 7 and 34 of chapter I of title 12 of the Code of Federal Regulations are amended as follows:

PART 7—BANK ACTIVITIES AND OPERATIONS

- *The authority citation for part 7 is revised to read as follows:*

Authority: 12 USC 1 *et seq.,* 71, 71a, 92, 92a, 93, 93a, 481, 484, and 1818.

Subpart D—Preemption

- *2. A new § 7.4007 is added to read as follows:*

§ 7.4007 Deposit-taking.

(a) *Authority of national banks.* A national bank may receive deposits and engage in any activity incidental to receiving deposits, including issuing evidence of accounts, subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any other applicable federal law.

(b) *Applicability of state law.* (1) Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its deposit-taking powers are not applicable to national banks.

(2) A national bank may exercise its federally authorized deposit-taking powers without regard to state law limitations concerning:

(i) Abandoned and dormant accounts;[3] [77]

(ii) Checking accounts;

(iii) Disclosure requirements;

(iv) Funds availability;

(v) Savings account orders of withdrawal;

(vi) State licensing or registration requirements (except for purposes of service of process); and

(vii) Special purpose savings services;[4] [78]

(c) *State laws that are not preempted.* State laws on the following subjects are not inconsistent with the deposit-taking powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national banks' deposit-taking powers:

(1) Contracts;

(2) Torts;

(3) Criminal law;[5] [79]

(4) Rights to collect debts;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

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[77] [3] This does not apply to state laws of the type upheld by the United States Supreme Court in *Anderson Nat'l Bank* v. *Luckett,* 321 U.S. 233 (1944), which obligate a national bank to "pay [deposits] to the persons entitled to demand payment according to the law of the state where it does business." *Id.* at 248–249.[77] [4] State laws purporting to regulate national bank fees and charges are addressed in 12 CFR 7.4002.

[78] [4] State laws purporting to regulate national bank fees and charges are addressed in 12 CFR 7.4002.

[79] [5] *But see* the distinction drawn by the Supreme Court in *Easton* v. *Iowa,* 188 U.S. 220, 238 (1903) between "crimes defined and punishable at common law or by the general statutes of a state and crimes and offences cognizable under the authority of the United States." The Court stated that "[u]ndoubtedly a state has the legitimate power to define and punish crimes by general laws applicable to all persons within its jurisdiction. . . . But it is without lawful power to make such special laws applicable to banks organized and operating under the laws of the United States." *Id.* at 239 (holding that federal law governing the operations of national banks preempted a state criminal law prohibiting insolvent banks from accepting deposits).

(8) Any other law the effect of which the OCC determines to be incidental to the deposit-taking operations of national banks or otherwise consistent with the powers set out in paragraph (a) of this section.

- *3. A new § 7.4008 is added to read as follows:*

§ 7.4008 Lending.

(a) *Authority of national banks.* A national bank may make, sell, purchase, participate in, or otherwise deal in loans and interests in loans that are not secured by liens on, or interests in, real estate, subject to any terms, conditions, and limitations prescribed by the Comptroller of the Currency and any other applicable federal law.

(b) *Standards for loans.* A national bank shall not make a consumer loan subject to this § 7.4008 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors.

(c) *Unfair and deceptive practices.* A national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act, 15 USC 45(a)(1), and regulations promulgated thereunder in connection with loans made under this § 7.4008.

(d) *Applicability of state law.* (1) Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its federally authorized non-real estate lending powers are not applicable to national banks.

(2) A national bank may make non-real estate loans without regard to state law limitations concerning:

(i) Licensing, registration (except for purposes of service of process), filings, or reports by creditors;

(ii) The ability of a creditor to require or obtain insurance for collateral or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices;

(iii) Loan-to-value ratios;

(iv) The terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;

(v) Escrow accounts, impound accounts, and similar accounts;

(vi) Security property, including leaseholds;

(vii) Access to, and use of, credit reports;

(viii) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;

(ix) Disbursements and repayments; and

(x) Rates of interest on loans.[6] [80]

(e) *State laws that are not preempted.* State laws on the following subjects are not inconsistent with the non-real estate lending powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national banks' non-real estate lending powers:

(1) Contracts;

(2) Torts;

(3) Criminal law;[7] [81]

(4) Rights to collect debts;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

(8) Any other law the effect of which the OCC determines to be incidental to the non-real estate lending operations of national banks or otherwise consistent with the powers set out in paragraph (a) of this section.

[80] [6] The limitations on charges that comprise rates of interest on loans by national banks are determined under federal law. *See* 12 USC 85; 12 CFR 7.4001. State laws purporting to regulate national bank fees and charges that do not constitute interest are addressed in 12 CFR 7.4002.

[81] [7] *See supra* note 5 regarding the distinction drawn by the Supreme Court in *Easton* v. *Iowa,* 188 U.S. 220, 238 (1903) between "crimes defined and punishable at common law or by the general statutes of a state and crimes and offences cognizable under the authority of the United States."

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- *4. A new § 7.4009 is added to read as follows:*

§ 7.4009 Applicability of state law to national bank operations.

(a) *Authority of national banks.* A national bank may exercise all powers authorized to it under federal law, including conducting any activity that is part of, or incidental to, the business of banking, subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any applicable federal law.

(b) *Applicability of state law.* Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its powers to conduct activities authorized under federal law do not apply to national banks.

(c) *Applicability of state law to particular national bank activities.* (1) The provisions of this section govern with respect to any national bank power or aspect of a national bank's operations that is not covered by another OCC regulation specifically addressing the applicability of state law.

(2) State laws on the following subjects are not inconsistent with the powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national bank powers:

(i) Contracts;

(ii) Torts;

(iii) Criminal law;

(iv) Rights to collect debts;

(v) Acquisition and transfer of property;

(vi) Taxation;

(vii) Zoning; and

(viii) Any other law the effect of which the OCC determines to be incidental to the exercise of national bank powers or otherwise consistent with the powers set out in paragraph (a) of this section.

Part 34—Real Estate Lending and Appraisals

Subpart A—General

- *5. The authority citation for part 34 continues to read as follows:*

Authority: 12 USC 1 *et seq.,* 29, 93a, 371, 1701j–3, 1828(o), and 3331 *et seq.*

- *6. In § 34.3, the existing text is designated as paragraph (a), and a new paragraph (b) is added to read as follows:*

§ 34.3 General rule.

* * * * *

(b) A national bank shall not make a consumer loan subject to this subpart based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors.

(c) A national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act, 15 USC 45(a)(1), and regulations promulgated thereunder in connection with loans made under this part.

- *7. Section 34.4 is revised to read as follows:*

§ 34.4 Applicability of state law.

(a) Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its federally authorized real estate lending powers do not apply to national banks. Specifically, a national bank may make real estate loans under 12 USC 371 and § 34.3, without regard to state law limitations concerning:

(1) Licensing, registration (except for purposes of service of process), filings, or reports by creditors;

(2) The ability of a creditor to require or obtain private mortgage insurance, insurance for other collateral, or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices;

(3) Loan-to-value ratios;

(4) The terms of credit, including schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;

(5) The aggregate amount of funds that may be loaned upon the security of real estate;

(6) Escrow accounts, impound accounts, and similar accounts;

(7) Security property, including leaseholds;

(8) Access to, and use of, credit reports;

(9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;

(10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;

(11) Disbursements and repayments;

(12) Rates of interest on loans;[1] [82]

(13) Due-on-sale clauses except to the extent provided in 12 USC 1701j–3 and 12 CFR part 591; and

(14) Covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan.

(b) State laws on the following subjects are not inconsistent with the real estate lending powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national banks' real estate lending powers:

(1) Contracts;

(2) Torts;

(3) Criminal law;[2] [83]

(4) Homestead laws specified in 12 USC 1462a(f);

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[82] [1] The limitations on charges that comprise rates of interest on loans by national banks are determined under federal law. *See* 12 USC 85 and 1735f–7a; 12 CFR 7.4001. State laws purporting to regulate national bank fees and charges that do not consitute interest are addressed in 12 CFR 7.4002.

[83] [2] *But see* the distinction drawn by the Supreme Court in *Easton* v. *Iowa,* 188 U.S. 220, 238 (1903) between "crimes defined and punishable at common law or by the general statutes of a state and crimes and offences cognizable under the authority of the United States." The Court stated that "[u]ndoubtedly a state has the legitimate power to define and punish crimes by general laws applicable to all persons within its jurisdiction. . . . But it is without lawful power to make such special laws applicable to banks organized and operating under the laws of the United States." *Id.* at 239 (holding that federal law governing the operations of national banks preempted a state criminal law prohibiting insolvent banks from accepting deposits).

(5) Rights to collect debts;

(6) Acquisition and transfer of real property;

(7) Taxation;

(8) Zoning; and

(9) Any other law the effect of which the OCC determines to be incidental to the real estate lending operations of national banks or otherwise consistent with the powers and purposes set out in § 34.3(a).

Dated: January 6, 2004

John D. Hawke, Jr.
Comptroller of the Currency

Visitorial Powers Final Rule

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 7
[Docket No. 04–03]
RIN 1557–AC78
[BILLING CODE 4810–33–P]

Bank Activities and Operations

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

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is publishing its final rule amending its visitorial powers regulation in order to clarify issues that have arisen in connection with the scope of the OCC's visitorial powers.

EFFECTIVE DATE: February 12, 2004.

FOR FURTHER INFORMATION CONTACT: For questions concerning the final rule, contact Andra Shuster, Counsel, or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities Division, (202) 874–5090.

SUPPLEMENTARY INFORMATION: On February 7, 2003, the OCC published a notice of proposed rulemaking in the *Federal Register* (68 FR 6363) to implement the American Homeownership and Economic Opportunity Act of 2000 (AHEOA) and clarify our visitorial powers regulation (NPRM). In addition, we proposed to amend parts 5, 7, 9, and 34 of our regulations for other purposes and to make various technical changes to correct citations or footnote numbering.

On December 17, 2003, the OCC published a final rule that addressed all of the foregoing parts of the proposal except visitorial powers (68 FR 70122). This final rule relates solely to the visitorial powers proposal (Proposal).

The OCC received 55 comments on the NPRM. Of these, 53 comments addressed the visitorial powers proposal. These comments included three from national banks, one from an operating subsidiary of a national bank, six from bank holding companies, five from banking trade associations, two from bank membership organizations, one from a community group association, two from non-profit consumer groups, one from a state bank supervisors' association, 30 from state bank supervisors' offices, one from a securities administrators' membership organization, and one from a law enforcement association.

While many of the commenters supported the proposal, some were opposed, and many offered suggestions for changes. For the reasons discussed later in this preamble, we have adopted the visitorial powers provisions of the NPRM with certain modifications also described later.

A. Background

Current 12 CFR 7.4000(a) provides that only the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks, subject to exceptions provided in federal law. Section 7.4000(a) goes on to define the regulatory, supervisory, and enforcement actions included within our visitorial powers, while § 7.4000(b) sets out several exceptions to our exclusive authority that are created by federal law.[1]

These provisions interpret and implement 12 USC 484. Paragraph (a) of that section states—

> No national bank shall be subject to any visitorial powers except as authorized by *Federal* law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

Paragraph (b) of the statute then permits lawfully authorized state auditors or examiners to review a national bank's records "solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws."

In recent years, various questions have arisen with respect to the scope of the OCC's visitorial powers over national banks. In general, the questions fall into two broad categories: First, what activities conducted by a national bank are subject to the OCC's *exclusive* visitorial powers? Second, what is the meaning of certain exceptions to the OCC's exclusive visitorial powers that are provided in the statute, specifically the exception for visitorial powers "vested in the courts of justice?"

The NPRM invited comments on proposed amendments to § 7.4000 to clarify the application of section 484 to both areas.

B. Description of the Proposal

The proposal contained two types of changes to § 7.4000. First, we proposed to add a new paragraph (3) to § 7.4000(a) that identifies the scope of the activities of national banks for which the OCC's visitorial powers are exclusive, pursuant to section 484. The proposal provided that the

[1] Paragraph (c) of 12 CFR 7.4000 clarifies that the OCC owns reports of examination and addresses a bank's obligations with respect to these reports. This paragraph is unaffected by this rulemaking.

OCC has exclusive visitorial authority over national bank activities that are permissible under federal law or regulation or OCC issuance or interpretation, including how those activities are conducted. Second, we proposed to revise § 7.4000(b) to clarify the OCC's interpretation of the "vested in the courts of justice" exception. The proposal provided that national banks are subject to the visitorial power inherently vested in courts and that the "vested in the courts of justice" exception did not create or expand any authority of states or other governmental entities to regulate or supervise national banks. As we will discuss in greater detail later in this preamble, both of these changes serve to clarify that federal law commits the supervision of national banks' federally authorized banking business exclusively to the OCC, (except where federal law provides otherwise), and does not apportion that responsibility among the OCC and the states; and that state authorities may not achieve indirectly by resort to judicial actions what section 484 prohibits them from achieving directly through state regulatory or supervisory mechanisms. The proposal also added an exception in proposed new § 7.4000(b)(vi) recognizing that functional regulators may exercise the authority over national banks conferred by the Gramm–Leach–Bliley Act (GLBA).[2]

C. Overview of Comments Received

Many commenters supported the proposal, noting that the clarification of the visitorial powers regulations would be helpful. One commenter said that subjecting national banks' federally authorized activities to state regulation would be inconsistent with the purposes of the National Bank Act. Others noted that additional layers of state supervision would have the effect of making the operations of national banks less efficient and more costly. Commenters also stated that they supported the proposal's clarification of the "courts of justice" exception. A number of commenters supporting the proposal suggested that, while the reference in the preamble is helpful, the OCC should add language to the regulation text to explicitly state that the OCC's exclusive visitorial authority applies to operating subsidiaries.

We also received a number of comments that opposed the proposal. These commenters advanced four principal points:

- first, that the visitorial powers amendments are inconsistent with the fundamental tenets of the dual banking system, pursuant to which national banks are subject to state regulation;
- second, that the amendments are inconsistent with the presumptive applicability of state law to national banks, as endorsed by the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle–Neal Act)[3];

[2] Pub. L. 106–102, 113 Stat. 1338 (November 12, 1999). For example, section 301 of the GLBA (codified at 15 USC 6711) provides that national banks' insurance activities are functionally regulated by the states, subject to the applicability of state law provisions in section 104 of that law (codified at 15 USC 6701). *Id.* at section 301, 113 Stat. at 1407, codified at 15 USC 6711.

[3] Pub. L. 103–328, 108 Stat. 2338 (September 29, 1994).

- third, that the OCC's visitorial power over national banks is not exclusive; and,
- finally, that the OCC lacks authority to prevent states from exercising visitorial powers over national bank operating subsidiaries.

The following discussion addresses each of these points.

D. Discussion

1. The exclusivity of the OCC's visitorial authority is integral to—not inconsistent with—the dual banking system.

Many commenters opposed to the proposal argued that the amendments would amount to a "field preemption" that would be inconsistent with what they aver to be a fundamental tenet of the dual banking system, namely, that states have the authority to regulate the business operations of all banks, including national banks, unless Congress preempts state law in specific areas.

This argument mischaracterizes the essence of the dual banking system. Differences in national and state bank powers and in the supervision and regulation of national and state banks are not inconsistent with the dual banking system; rather they are the defining characteristics of it. As one noted commenter has observed, "[t]he very core of the dual banking system is the simultaneous existence of different regulatory options that are *not* alike in terms of statutory provisions, regulatory implementation and administrative policy."[4] The federal grant of national bank powers and the uniformity of the standards that govern their exercise, coupled with the OCC's exclusive visitorial authority, are fundamental distinctions between the national banking system and the system of state-chartered and regulated banks that comprises the other half of the dual banking system.

Neither the case law nor scholarly literature recognizes a definition of dual banking incorporating the notion that national banks are subject to state supervision and regulation of activities they are authorized to conduct under federal banking law.[5] What the case law *does* recognize is that "states retain some power to regulate national banks in areas such as contracts, debt collection, acquisi-

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[4] Kenneth E. Scott, "The Dual Banking System: A Model of Competition in Regulation," 30 Stan. L. Rev. 1, 41 (1977).

[5] The following is typical of the way the dual banking system is described in recent scholarly articles:

> Depository financial institutions in the United States, including banks, credit unions, and thrifts, are unique in that their incorporators and/or management have a choice between state and federal charters, regulatory authorities, and governing statutes. No other industry has separate and distinct laws governing its powers, regulation, and organizational structure. This phenomenon is known as the "dual banking system."

John J. Schroeder, "'Duel' Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions," 36 Ind. L. Rev. 197, at 197 (2003), citing Arthur E. Wilmarth, Jr., "The Dual Banking System—A Legal History" (September 30, 1991) (unpublished paper presented at the Education Foundation of State Bank Supervisors (EFSBS) Seminar for State Banking Department Attorneys).

tion and transfer of property, and taxation, zoning, criminal, and tort law."[6] Application of these laws to national banks and their implementation by state authorities typically does not affect the content or extent of the federally authorized business of banking conducted by national banks, but rather establishes the legal infrastructure that surrounds and supports the ability of national banks—and others—to do business.[7] In other words, these state laws provide a framework for a national bank's ability to exercise powers granted under federal law; they do not obstruct or condition a national bank's exercise of those powers.[8]

The argument that the proposed amendments generally amount to an impermissible "field preemption" is also misplaced. First, the regulatory proposal and the final regulation would not have the effect of preempting substantive state laws, but rather would clarify the appropriate agency for enforcing those state laws that are applicable to national banks. Concerns about "field preemption" are misplaced since the rule pertains only to state laws that would provide for state "visitation" of national banks. The proposal and this final rule interpret the text of a federal statute, 12 USC 484, that expressly confines the scope of permissible supervision over national banks to what is provided in federal law, including the limited exception for state inspection of certain records that is contained in section 484. Thus, Congress has spoken to the issue. Our amendments to our visitorial powers rule seek to define the terms used in the statute in order to provide greater certainty to affected parties with regard to the specific issue of visitation.

2. No presumption against preemption applies in the case of the national banking laws, a conclusion that is confirmed by the Riegle–Neal Act.

Commenters also argued that the amendments in the proposal are inconsistent with the presumptive application of state law to national banks, which they assert was specifically endorsed by Congress in the Riegle–Neal Act.[9]

However, case law, whether decided before or after Riegle–Neal was enacted, is consistent in holding that there is no presumption against preemption in the national bank context. The Su-

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[6] *Bank of America* v. *City & County of San Francisco,* 309 F.3d 551, 559 (9th Cir. 2002).

[7] The OCC is publishing in the *Federal Register* today a final rule amending parts 7 and 34 of the OCC's regulations to clarify that these state "infrastructure" statutes would generally not be preempted by federal law.

[8] *See Barnett Bank of Marion County, N.A.* v. *Nelson,* 517 U.S. 25, 33–34 (1996).

[9] Commenters rely on the legislative history of the Riegle–Neal Act as support for their assertions. This history demonstrates that Congress intended that the Riegle–Neal Act would *not* disrupt the application of traditional principles of federal preemption to questions involving national banks. We note, however, that under well-established principles of statutory construction, it is not necessary to resort to legislative history to determine the meaning of a statute unless the text of the statute is ambiguous, which is not the case here. *See, e.g., Burlington Northern R.R. Co.* v. *Oklahoma Tax Commission,* 481 U.S. 454, 461 (1987) (unless there are exceptional circumstances, judicial inquiry into the meaning of a statute is complete once the court finds that the terms of the statute are unambiguous.) (citation omitted); *see also* 2A Norman J. Singer, Sutherland, *Statutes and Statutory Construction* § 48.01, at 410 (6th ed. 2000) ("Generally, a court would look to the legislative history for guidance when the enacted text was capable of two reasonable readings or when no one path of meaning was clearly indicated.").

preme Court has said that a presumption against preemption "is not triggered when the State regulates in an area where there has been a history of significant federal presence."[10] Courts have consistently held that the regulation of national banks is an area where there has been an extensive history of significant federal presence. As recently observed by the U.S. Court of Appeals for the Ninth Circuit, "since the passage of the National Bank Act in 1864, the federal presence in banking has been significant." The court thus specifically concluded that "the presumption against preemption of state law is inapplicable."[11] Indeed, when analyzing national bank powers, the Supreme Court has interpreted "grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law."[12]

The relevant text of the Riegle–Neal Act is fully consistent with these conclusions. In fact, it is entirely consistent with the proposal and final rule in providing that even when state law may be applicable to interstate branches of national banks, the OCC is to enforce such laws, *i.e.,* the OCC retains exclusive visitorial authority:

> (A) In general
>
> The laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State, *except—*
>
> (i) *when Federal law preempts the application of such State laws to a national bank;* . . .
>
> (B) Enforcement of applicable State laws
>
> The provisions of any State law to which a branch of a national bank is subject under this paragraph *shall be enforced,* with respect to such branch, *by the Comptroller of the Currency.*[13]

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[10] *U.S.* v. *Locke,* 529 U.S. 89, 108 (2000) (explaining *Rice* v. *Santa Fe Elevator Corp.,* 331 U.S. 218 (1947)).

[11] *Bank of America,* 309 F.3d at 558–59 (citations omitted).

[12] *Barnett,* 517 U.S. at 32. The *Barnett* Court went on to elaborate:

> [W]here Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies. In *Franklin Nat. Bank,* the Court made this point explicit. It held that Congress did not intend to subject national banks' power to local restrictions, because the federal power-granting statute there in question contained 'no indication that Congress [so] intended . . . as it has done *by express language* in several other instances.'
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> *Id.* at 34 (emphasis in original) (citations omitted).

[13] 12 USC 36(f)(1) (emphasis added).

Thus, although Riegle–Neal section 36(f) clarifies that the laws of the host state regarding community reinvestment, consumer protection, and fair lending would be applicable to branches of an out-of-state national bank located in the host state, *unless preempted*, the Riegle–Neal Act further and unambiguously provides that it is the OCC that has the authority to enforce such state laws to the extent they are *not* preempted.

3. Section 484 grants visitorial authority to the OCC, to the exclusion of the states.

Some commenters argued that the OCC's visitorial power is not exclusive because (1) the text of the statute does not contain an explicit grant of exclusive authority to the OCC; and (2) courts have permitted states to exercise concurrent authority to seek enforcement of state laws. These two contentions are addressed in turn.

a. The text of section 484

Commenters who opposed the proposal argued that the OCC may not rely on 12 USC 484 as the basis for our exclusive jurisdiction because that section is silent on precisely who has visitorial powers over national banks. A review of the history of section 484 shows that this reading of the statute is fundamentally mistaken.

In the Act of June 3, 1864, later named the National Bank Act, the visitorial powers provision appeared in the *same section* as the Comptroller's examination authority. In that context, it was clear that visitorial authority was exclusive to the Comptroller, subject to a single exception for powers "vested in the several courts of law and chancery." Section 54 of the National Bank Act provided in relevant part:

> *And be it further enacted,* That the comptroller of the currency, with the approbation of the Secretary of the Treasury, as often as shall be deemed necessary or proper, shall appoint a suitable person or persons to make an examination of the affairs of every banking association. . . . And the association shall not be subject to any other visitorial powers than such as are authorized by this act, except such as are vested in the several courts of law and chancery.[14]

These examination and visitorial provisions of section 54 were codified together in 1875 at section 5240 of the Revised Statutes of the United States. Section 5240 explicitly gave the OCC visitorial authority over national banks *and* precluded the exercise of visitorial authority by any other source, except insofar as expressly allowed by one of the exceptions, including the exception covering visitations "as authorized by federal law." In context, the meaning of the text is unmistakable. The Comptroller is given the power to examine and supervise national banks—that is, to serve as the "visitor" of the bank—and that power, as well as any other "visitorial" power is denied to any other entity unless federal law provides otherwise.

[14] Act of June 3, 1864, c. 106, § 54, 13 Stat. 116, codified at 12 USC 481–484.

The examination and visitorial provisions were split, slightly revised, then later reunited, in subsequent codifications,[15] but Congress has never altered the original meaning of these grants of authority to the OCC. The visitorial provision has been substantively amended only twice, once in 1913 and once in 1982.[16] Both times, the amendments were consistent with the exclusive grant of visitorial authority in the original enactment. In both cases, the legislative history, though sparse, contains no indication that Congress intended to change the exclusivity of its original grant of authority to the Comptroller. In fact, the 1982 amendment that added the exception allowing state authorities to review national bank records to ascertain compliance with state escheat or unclaimed property laws would have been unnecessary if the language of section 484 permitted state examination and enforcement of applicable state law. As codified today, the examination and visitorial provisions appear in separate sections of the United States Code. Substantive consequences do not attach to the placement of the provisions in the Code, however, and neither provision may be read in isolation to suggest a meaning that is inconsistent with the law as enacted by the Congress.

Moreover, exclusivity is inherent in the structure of the statute, both as originally enacted and today. The visitorial powers provision first sets forth a complete prohibition, then subjects that prohibition to certain exceptions.[17] The inference to be drawn from this structure is that the prohibition applies unless a visitorial power is covered by one of the enumerated exceptions. As noted above, the statute's description of the exceptions has changed—though the changes have been modest—over time. But none of these exceptions allows for the allocation of any general bank supervisory responsibility to the states.

As we discussed when we issued the visitorial powers proposal, any allocation of general supervisory authority over national banks to the states would be inconsistent with the history and purpose of the National Bank Act, as well as with the express language of the statute. Congress enacted the National Currency Act (Currency Act) in 1863 and the National Bank Act the year after for the purpose of establishing a new national banking system that would operate distinctly and separately from the existing system of state banks. The Currency Act and National Bank Act were enacted to create a uniform and secure national currency and a system of national banks designed to help stabilize and support the post–Civil War national economy.

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[15] The examination provision is currently codified at 12 USC 481.

[16] In 1913, the exception for Congress and its committees was added, the reference to the Act of June 3, 1864 changed to "other than such as are authorized by *law,"* and the word "bank" substituted for the word "association." Amendments in 1982 added the exception allowing state authorities to review national bank records to ascertain compliance with state escheat or unclaimed property laws, added the word "federal" before the word "law," and changed "bank" to "national bank."

[17] Commenters cited to *First Union Nat'l Bank* v. *Burke,* 48 F. Supp. 2d 132 (D. Conn. 1999), in support of their contention that the OCC's visitorial power is not exclusive. We disagree that the court's opinion is dispositive of the issues considered here. The opinion did not analyze the purpose, plain language, and structure of section 484. Moreover, we note that the *Burke* court agreed that a state may not directly enforce state law against national banks.

Both proponents and opponents of the new national banking system expected that it would supersede the existing system of state banks.[18] Given this anticipated impact on state banks and the resulting diminution of control by the states over banking in general,[19] proponents of the national banking system were concerned that states[20] would attempt to undermine it. Remarks of Senator Sumner illustrate the sentiment of many legislators of the time: "Clearly, the bank must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions."[21]

The allocation of any supervisory responsibility for the new national banking system to the states would have been inconsistent with this need to protect national banks from state interference.[22]

[18] Representative Samuel Hooper, who reported the bill to the House, stated in support of the legislation that one of its purposes was "to render the law *[i.e.,* the Currency Act] so perfect that the State banks may be induced to organize under it, in preference to continuing under their State charters." Cong. Globe, 38th Cong. 1st Sess. 1256 (March 23, 1864). While he did not believe that the legislation was necessarily harmful to the state bank system, Rep. Hooper did "look upon the system of State banks as having outlived its usefulness." *Id.* Opponents of the legislation believed that it was intended to "take from the States . . . all authority whatsoever over their own State banks, and to vest that authority . . . in Washington." Cong. Globe, 38th Cong., 1st Sess. 1267 (March 24, 1864) (statement of Rep. Brooks). Rep. Brooks made that statement to support the idea that the legislation was intended to transfer control over banking from the states to the federal government. Given that the legislation's objective was to replace state banks with national banks, its passage would, in Rep. Brooks's opinion, mean that there would be no state banks left over which the states would have authority. Thus, by observing that the legislation was intended to take authority over state banks from the states, Rep. Brooks was not suggesting that the federal government would have authority over state banks; rather, he was explaining the bill in a context that assumed the demise of state banks. Rep. Pruyn opposed the bill stating that the legislation would "be the greatest blow yet inflicted upon the States." Cong. Globe, 38th Cong., 1st Sess. 1271 (Mar. 24, 1864). *See also* John Wilson Million, "The Debate on the National Bank Act of 1863," 2 J. Pol. Econ. 251, 267 (1893–94) regarding the Currency Act. ("Nothing can be more obvious from the debates than that the national system was to supersede the system of state banks.").

[19] *See, e.g., Tiffany* v. *Nat'l Bank of Missouri,* 85 U.S. 409, 412–413 (1874) ("It cannot be doubted, in view of the purpose of Congress in providing for the organization of National banking associations, that it was intended to give them a firm footing in the different States where they might be located. It was expected they would come into competition with State banks, and it was intended to give them at least equal advantages in such competition. . . . National banks have been National favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States, or to ruinous competition with State banks."); *Beneficial Nat'l Bank* v. *Anderson,* 123 S. Ct. 2058, 2064 (2003) ("[T]his Court has also recognized the special nature of federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system that needed protection from 'possible unfriendly State legislation.'") (citation omitted). *See also* Bray Hammond, *Banks and Politics in America from the Revolution to the Civil War* 725–34 (1957); Paul Studenski and Herman E. Krooss, *Financial History of the United States* 154–55 (1952).

[20] For ease of reference, we use the term "state" in this preamble in a way that includes other non-federal governmental entities.

[21] Cong. Globe, 38th Cong., 1st Sess., at 1893 (April 27, 1864); *see also Beneficial Nat'l Bank,* 123 S.Ct. at 2064.

[22] In a report of the Comptroller of the Currency made pursuant to the Currency Act, Hugh McCulloch, then Comptroller, discussed the need to protect national banks from variation in interest rates among the states by making a change in the law to provide for uniform interest rates. He referred to the Supreme Court decision in *M'Culloch* v. *Maryland,* 17 U.S. 316 (1819), which prohibited the state of Maryland from imposing taxes on the Bank of the United States under the federal statute establishing the bank, as support for Congress having the authority to make this change by likening

Congress, accordingly, established a federal supervisory regime and created a federal agency within the Department of the Treasury—the OCC—to carry it out. Congress granted the OCC the broad authority "to make a thorough examination into all the affairs of [a national bank],"[23] and solidified this federal supervisory authority by vesting the OCC with exclusive visitorial powers over national banks. These provisions assured, among other things, that the OCC would have comprehensive authority to examine all the affairs of a national bank, *and* protected national banks from potential state hostility by establishing that the authority to examine and supervise national banks is vested *only* in the OCC, unless otherwise provided by federal law.[24]

Courts have consistently recognized the unique status of the national banking system and the limits placed on states by the National Bank Act. The Supreme Court stated in one of the first cases to address the role of the national banking system that "[t]he national banks organized under the [National Bank Act] are instruments designed to be used to aid the government in the administration of an important branch of the public service. They are means appropriate to that end."[25] Subsequent opinions of the Supreme Court have been equally clear about national banks' unique role and status.[26]

In *Guthrie* v. *Harkness,*[27] the Supreme Court recognized how the National Bank Act furthered the objectives of Congress:

> Congress had in mind in passing this section [section 484] that in other sections of the law it had made full and complete provision for investigation by the Comptroller of the Currency and examiners appointed by him, and, authorizing the appointment of a receiver, to take possession of the business with a view to winding up the affairs of the bank. It was the intention that this statute should contain a full code of provisions upon the subject, and that

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the Maryland taxation statute to a state statute on interest. Office of the Comptroller of the Currency, "Report on the Finances," November 28, 1863, at 52–53.

[23] Act of June 3, 1864, c. 106, § 54, 13 Stat. 116, codified at 12 USC 481.

[24] Writing shortly after the Currency Act and National Bank Act were enacted, then–Secretary of the Treasury, and formerly the first Comptroller of the Currency, Hugh McCulloch observed that "Congress has assumed entire control of the currency of the country, and, to a very considerable extent, of its banking interests, prohibiting the interference of State governments." Letter of Secretary of the Treasury, serial set collection, CIS No. 1239 S.misdoc.100, 39th Cong., 1st Sess., Misc. Doc. No. 100, at 2 (April 23, 1866).

[25] *Farmers' & Mechanics' Nat'l Bank* v. *Dearing,* 91 U.S. 29, 33 (1875).

[26] *See Marquette Nat'l Bank of Minneapolis* v. *First Omaha Service Corp.,* 439 U.S. 299, 314–315 (1978) ("Close examination of the National Bank Act of 1864, its legislative history, and its historical context makes clear that, . . . Congress intended to facilitate . . . a 'national banking system'." (citation omitted)); *Franklin Nat'l Bank of Franklin Square* v. *New York,* 347 U.S. 373, 375 (1954) ("The United States has set up a system of national banks as federal instrumentalities to perform various functions such as providing circulating medium and government credit, as well as financing commerce and acting as private depositories."); *Davis* v. *Elmira Sav. Bank,* 161 U.S. 275, 283 (1896) ("National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.").

[27] 199 U.S. 148, 159 (1905).

> no state law or enactment should undertake to exercise the right of visitation over a national corporation. Except in so far as such corporation was liable to control in the courts of justice, this act was to be the full measure of visitorial power.

The Supreme Court also has recognized the clear intent on the part of Congress to limit the authority of states over national banks precisely so that the nationwide system of banking that was created in the Currency Act could develop and flourish. For instance, in *Easton* v. *Iowa,*[28] the Court stated that federal legislation affecting 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 as numerous as the states . . . . It thus appears that Congress has provided a symmetrical and complete scheme for the banks to be organized under the provisions of the statute. . . . [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.*

And in *Farmers' & Mechanics' National Bank,* after observing that national banks are means to aid the government, the Court stated—

> Being such means, brought into existence for this purpose, and intended to be so employed, the States can exercise no control over them, nor in any wise affect their operation, except in so far as Congress may see proper to permit. Any thing beyond this is "an abuse, because it is the usurpation of power which a single State cannot give."[29]

Our proposed amendment clarifying the scope of the visitorial powers authorized to the OCC pursuant to section 484 is consistent with the historical meaning of the term "visitation" and with cases discussing section 484. The Supreme Court in *Guthrie* noted that the term "visitorial" as used in section 484 derives from English common law, which used the term "visitation" to refer to the act of a superintending officer who visits a corporation to examine its manner of conducting business and enforce observance of the laws and regulations.[30] "'Visitors of corporations have

[28] 188 U.S. 220, 229, 231–32 (1903) (emphasis added).

[29] 91 U.S. at 34 (citations omitted).

[30] *Guthrie,* 199 U.S. at 158, citing *First Nat'l Bank of Youngstown* v. *Hughes,* 6 F. 737, 740 (C.C.D. Ohio 1881), *appeal dismissed,* 106 U.S. 523 (1883)). Because "visitation" assumes the act of a sovereign body, private actions brought by individuals against banks in pursuit of personal claims ordinarily are outside the scope of visitorial powers rules. This point is discussed further in the analysis of the arguments asserting concurrent jurisdiction between state and federal courts over national banks, *infra.*

power to keep them within the legitimate sphere of their operations, and to correct all abuses of authority, and to nullify all irregular proceedings.'"[31] The *Guthrie* Court also noted that visitorial powers include bringing "judicial proceedings" against a corporation to enforce compliance with applicable law.[32]

b. Concurrent enforcement jurisdiction

Several commenters asserted that states retain jurisdiction concurrent with the OCC to enforce compliance with state laws against national banks in both state and federal court.[33] The cases cited by commenters in support of this contention are examples of the use of courts for private civil cases in pursuit of personal claims against national banks, which, unlike attempts by state authorities to exercise authority over national banks using the courts, do not amount to visitations.[34] Other cases cited by commenters appear inapposite or outdated.[35]

A few commenters cited *First National Bank in St. Louis* v. *Missouri*[36] to support their position that states may bring enforcement actions directly against national banks.[37] In *St. Louis,* the court

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[31] *Id.* (citation omitted).

[32] *Id. See also Peoples Bank of Danville* v. *Williams,* 449 F. Supp. 254, 259 (W. D. Va. 1978) (visitorial powers involve the exercise of the right of inspection, superintendence, direction, or regulation over a bank's affairs). For a detailed discussion of the historical scope and content of visitorial powers generally, *see* Roscoe Pound, *Visitatorial Jurisdiction Over Corporations in Equity,* 49 Harv. L. Rev. 369 (1935–36).

[33] We note that the National Bank Act did confer jurisdiction on both state and federal courts over actions against national banks. *See* Act of June 3, 1864, § 57. Nothing in the grant of jurisdiction says or implies that state authorities may use the judiciary as the medium to supervise, examine, or regulate the business of national banks, as commenters have asserted.

[34] *First Nat'l Bank of Charlotte* v. *Morgan,* 132 U.S. 141 (1889) (private action for usury against national banks may be brought in state court); *Bank of Bethel* v. *Pahquioque Bank,* 81 U.S. 383 (1872) (private creditors may sue national bank in state court).

[35] *See, e.g., Guthrie,* 199 U.S. 148 (private civil action by a stockholder to compel, by writ of mandamus, the directors of a national bank to permit a stockholder to inspect the bank's books; private civil action, no state executive visitation involved); *Colorado Nat'l Bank of Denver* v. *Bedford,* 310 U.S. 41 (1940) (action for declaratory judgment; consistent with the OCC's final regulation, which does not regard actions for declaratory judgment as visitorial); *Waite* v. *Dowley,* 94 U.S. 527 (1877) (substantive preemption case that did not involve visitorial powers); and *First Nat'l Bank of Youngstown,* 6 F. at 741 (no visitation involved where state taxation authorities used court to compel production of bank's records in aid of taxation of individual depositors; state actions did "not contemplate inspection, supervision, or regulation of [the bank's] business, or an enforcement of its laws or regulations.").

[36] 263 U.S. 640 (1924).

[37] In *St. Louis,* the state of Missouri brought a *quo warranto* action to stop a national bank from operating a branch in the state. The state had a law prohibiting branch banking. The Supreme Court held that the state statute was applicable to national banks and could be enforced by the state. *Quo warranto* is "[a] common law writ designed to test whether a person exercising power is legally entitled to do so. An extraordinary proceeding, prerogative in nature, addressed to preventing a continued exercise of authority unlawfully asserted. . . . It is intended to prevent exercise of powers that are not conferred by law, and is not ordinarily available to regulate the manner of exercising such powers." *Black's Law Dictionary* (6th ed. 1990) (citation omitted). Today, such an issue would be raised via an action for a declaratory judgment.

upheld a state's ability to preclude, through an action *quo warranto,* a national bank's exercise of a power that was not then authorized to it, namely, intrastate branching.

St. Louis presents a unique set of circumstances, now outdated, and did not discuss the scope of section 484; thus the case provides little help in construing section 484. The principal issue in the case was whether a national bank had the power to branch intrastate despite a state law prohibition on branching. The Court looked for express authority to branch intrastate in the text of the National Bank Act and, finding none, concluded that the activity was not authorized. The Court then went on to permit Missouri to enforce its intrastate branching prohibition against the national bank. To the extent that *St. Louis* is still relevant, the case holds that a state may enforce a prohibition against a national bank where: (a) the national bank is found to lack the fundamental authority to engage in an activity;[38] (b) the state has a law prohibiting the activity entirely; and (c) no federal enforcement mechanism is available to preclude the bank from violating the applicable state law.

The principal means in use today for testing the application of state law to national banks—declaratory judgment—was unavailable to the states prior to the enactment of the Declaratory Judgment Act in 1934, 28 USC 2201 through 2202. If this type of action had been available at the time of the *St. Louis* case, there would have been no need for the state to bring a *quo warranto* action. Subsequent cases concerning the power of national banks to branch have typically been brought as declaratory judgments.[39]

Moreover, the OCC has enforcement authority today that did not exist when *St. Louis* was decided. Congress authorized the OCC to bring enforcement actions predicated on, *inter alia,* violations of state law in 1966.[40] Thus, if state law that would regulate an aspect of a national bank's federally authorized banking business is not preempted, it would be enforced by the OCC, not the states.[41]

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[38] The power to branch intrastate was subsequently authorized for national banks by the McFadden Act in 1927. Act of February 25, 1927, c. 191, § 7, 44 Stat. 1228, codified at 12 USC 36.

[39] *See, e.g., Jackson* v. *First Nat'l Bank of Valdosta,* 349 F.2d 71 (5th Cir. 1965); *State of Utah, ex rel., Dep't of Financial Institutions* v. *Zions First Nat'l Bank of Ogden, Utah,* 615 F.2d 903 (10th Cir. 1980).

[40] Pub. L. 89–695, section 202, 80 Stat. 1028 (Oct. 16, 1966). For a violation of an applicable state law, the OCC may issue cease and desist orders, exercise its removal and prohibition authority, or impose civil money penalties. *See* 12 USC 1818(b), (e), and (i)(2).

[41] *See Nat'l State Bank, Elizabeth, N.J.* v. *Long,* 630 F.2d 981, 988 (3rd Cir. 1980). *See also State of Arizona* v. *Hispanic Air Conditioning and Heating, Inc.,* CV 2000–003625, Superior Court of Arizona, Ruling at 27–28, Conclusions of Law, paragraphs 46–55 (August 25, 2003). In this action involving a national bank defendant, the court found that restitution and remedial action ordered by OCC pursuant to its visitorial powers was comprehensive and significantly broader than that available through state court proceedings and that it provided more relief to consumers than the court found a legal basis for imposing under state law. The court also noted that ordering the remedies requested by the state would impermissibly affect the exercise of the OCC's administrative enforcement powers.

The essential elements of *St. Louis* thus are entirely consistent with our construction of the "courts of justice" exception as proposed. Moreover, our construction is consistent with the text and history of section 484, the purpose of that section in the context of the national banking laws, and with other U.S. Supreme Court and lower federal court precedents. The exception preserves the powers that are inherent in the courts. As we noted in the preamble to the proposal, Congress clearly did not intend to create new visitorial authority that could be exercised by state authorities when it recognized the authority of courts of justice. It would be completely contrary to the express purposes of section 484 to read the "vested in the courts of justice" exception as a new federal authorization for state authorities to accomplish exactly what Congress deliberately and expressly intended states *not* to be able to do—namely, inspect and supervise the activities of national banks and compel their adherence to a variety of state-set standards.

This purpose is effectuated by the plain language of the statute. The exception permits the exercise of "visitorial powers" that are *"vested* in the courts of justice," powers, in other words, that *courts possess.* Section 484 does not create new powers for state executive, legislative, or administrative authorities to supervise and regulate national banks. It grants no *new* authority and thus does not authorize states to bring suits or enforcement actions that they do not otherwise have the power to bring.

To read the *exception* as an authorization to permit state authorities to inspect, regulate, supervise, direct, or restrict the activities of national banks simply by filing a complaint in a court would be to *create* a visitorial power that states do not otherwise possess under federal law. Section 484 by its express terms simply does not create such boundless visitorial powers for state authorities. Where section 484 *does* recognize visitorial authority for states in section 484(b), by contrast, it is specific and narrow, and expressly stated as an *exception* to the general exclusivity of the OCC's visitorial powers recognized in section 484(a).

Under this construction of section 484, states remain free to seek a declaratory judgment from a court as to whether a particular state law applies to the federally authorized business of a national bank or is preempted. However, if a court rules that a state law is not preempted, enforcement of a national bank's compliance with a law that would govern the content or the conditions for conduct of a national bank's federally authorized banking business is within the OCC's exclusive purview.[42] In addition, it does not preclude actions brought by other governmental entities pursuant to a federal grant of authority.[43]

[42] *See Nat'l State Bank, Elizabeth, N.J.,* 630 F.2d at 988 ("[W]e find ourselves unable to agree with the district court's determination that state officials have the power to issue cease and desist orders against national banks for violations of the [state's] anti-redlining statute. Congress has delegated enforcement of statutes and regulations against national banks to the Comptroller of the Currency."); *see also First Union Nat'l Bank,* 48 F. Supp. 2d at 145–46.

[43] *See, e.g., Bank of America Nat'l Trust & Savings Ass'n* v. *Douglas,* 105 F.2d 100 (D.C. Cir. 1939) (service of subpoenas on a national bank by the SEC in connection with an investigation under the Securities Exchange Act of 1934).

4. The OCC has exclusive visitorial authority over national bank operating subsidiaries to the same extent as it has that authority over the parent national bank.

Commenters also asserted that the OCC lacks the authority to prevent states from exercising visitorial authority over national bank operating subsidiaries because they are state-chartered corporations and because section 484 does not specifically refer to operating subsidiaries. Some suggested that a curtailing of state authority over state corporations violates the 10th Amendment to the Constitution.[44] These points are discussed in order, however, it is important to note that the issue of the application of state law to national bank operating subsidiaries is dealt with in a different, preexisting regulation, 12 CFR 7.4006, which we did not propose to change. For the reasons discussed below, we continue to hold the view that under 12 USC 24(Seventh) and 12 CFR 7.4006, the standards of section 484 apply to national bank operating subsidiaries to the same extent as their parent national bank, and such a result is entirely consistent with Constitutional principles.

a. The OCC's exclusive visitorial authority over operating subsidiaries

Pursuant to their authority under 12 USC 24(Seventh), national banks have long used separately incorporated entities as a means to engage in activities that the bank itself is authorized to conduct. When established in accordance with OCC regulations and approved by the OCC, an operating subsidiary is a federally authorized and federally licensed means by which a national bank may conduct federally authorized activities. Courts have consistently treated operating subsidiaries as equivalent to national banks in determining their powers and status under federal law, unless *federal* law requires otherwise.[45] Operating subsidiaries are consolidated with—that is, their assets and liabilities are indistinguishable from—the parent bank for accounting purposes, regulatory reporting purposes, and for purposes of applying many federal statutory or regulatory limits.[46] They are, in essence, no more than incorporated departments of the bank itself.[47]

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[44] The Tenth Amendment reads as follows: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X.

[45] *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.,* 513 U.S. 251 (1995) (sale of annuities by operating subsidiary); *Clarke* v. *Securities Industry Ass'n,* 479 U.S. 388 (1987) (securities brokerage operating subsidiary); *American Ins. Ass'n* v. *Clarke,* 865 F.2d 278 (D.C. Cir. 1988) (bond insurance subsidiary); *M & M Leasing Corp.* v. *Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977) (auto leasing subsidiary); and *Valley Nat'l Bank* v. *Lavecchia,* 59 F. Supp. 2d 432 (D. N.J. 1999) (title insurance subsidiary); *Budnik* v. *Bank of America Mortgage,* 2003 U.S. Dist. LEXIS 22542 (N.D. IL 2003) (mortgage subsidiary).

[46] *See* 12 CFR 5.34(e)(4) (requiring application of, *e.g.,* statutory lending limit and limit on investment in bank premises to a national bank and its operating subsidiaries on a consolidated basis).

[47] The authority of national banks to conduct business through operating subsidiaries has been recognized for many years. For example, rulings published in the *Comptroller's Manual* in the mid 1960s permitted national banks to own, *e.g.,* mortgage companies and finance companies. A July 30, 1965, letter by Comptroller James J. Saxon concluded that the prohibition on stock ownership by national banks in 12 USC § 24(Seventh) does not apply "when such ownership is a proper incident to banking," as is the case with operating subsidiaries. *See also* 12 CFR 250.141, an interpretation by the Board of Governors of the Federal Reserve System adopted in 1968, which reaches the same conclusion regarding state member banks.

As a matter of federal law, operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent bank, including being subject to the exclusive visitorial authority of the OCC.[48] Where Congress wanted a different result, it specifically provided for it. For example, section 111 of GLBA makes provision for state regulation of functionally regulated bank subsidiaries conducting securities and insurance activities, treating such subsidiaries as if they were instead subsidiaries of the institution's holding company.[49] Similarly, section 133 of GLBA seeks to clarify the status of bank and thrift subsidiaries and affiliates for purposes of any provisions of the Federal Trade Commission Act applied by the Federal Trade Commission.[50]

Our regulations make clear that activities conducted in operating subsidiaries must be permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking.[51] Moreover, the operating subsidiary is acting "pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank."[52] This includes state laws that purport to govern the activities conducted in the operating subsidiary. OCC regulations specifically provide that "[u]nless 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."[53] Our regulations reflect express Congressional recognition in section 121 of the GLBA 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."[54] The "terms and conditions" that govern the conduct of operating subsidiary activities referenced in this provision include how, and by whom, the operating subsidiary is examined and supervised. Thus, operating subsidiaries are licensed, examined, and supervised by the same federal banking agency—the OCC—that examines and supervises national banks, using the same methodology as in the case of national banks.

Courts that have recently considered the issue have confirmed this conclusion. In *Wells Fargo Bank, N.A.* v. *Boutris,*[55] a federal district court issued a permanent injunction enjoining the Cali-

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[48] 12 CFR 5.34(e)(3); 12 CFR 7.4006.

[49] 12 USC 1844(c)(4).

[50] 15 USC 41 note. *See Minnesota* v. *Fleet Mortgage Corp.,* 181 F. Supp. 2d 995 (D. Minn. 2001). In addition, in the case of national bank "*financial* subsidiaries," which engage in activities *beyond* those permissible for the bank itself, Congress provided special standards regarding the application of state laws. Pub. L. 106–102, section 104, 113 Stat. 1338, 1352 (1999), codified at 15 USC 6701.

[51] *See* 12 CFR 5.34(e)(1).

[52] 12 CFR 5.34(e)(3).

[53] 12 CFR 7.4006.

[54] Pub. L. 106–102, section 121, 113 Stat. 1338, 1373 (1999), codified at 12 USC 24a(g)(3)(A).

[55] 265 F. Supp. 2d 1162 (E.D. Cal. 2003).

fornia Department of Corporations from exercising visitorial powers over a national bank operating subsidiary. The court noted the existing case law and concluded that the OCC's operating subsidiary regulation is within the agency's authority delegated to it by Congress and is a reasonable interpretation.[56]

Section 7.4006 of our rules already provides that state law applies to national bank operating subsidiaries to the same extent as it applies to the parent bank.[57] Thus, state laws purportedly forming the basis for the exercise of state regulatory or supervisory authority over national bank operating subsidiaries, which are inapplicable to the parent national bank, are similarly inapplicable to the bank's operating subsidiary. This conclusion is reinforced by the holdings of the court in the *Wells Fargo* and *National City* cases, just described.

b. The Tenth Amendment

Recent case law also confirms that the final rule does not conflict with the 10th Amendment. In the *Wells Fargo* case, *supra,* the California commissioner argued that the OCC was interfering with the state's sovereignty under the 10th Amendment by taking away its power to regulate and enforce laws against state-chartered corporations. The court held that once the OCC authorized the operating subsidiary of the national bank, it ceased being subject to the visitorial power of the state commissioner and that this change was not shown to infringe on California's rights under the 10th Amendment. The court noted that "the Constitution authorizes Congress to establish national banks" and that "*[t]he National Bank Act's effect of 'carving out from state control supervisory authority' over an OCC-authorized operating subsidiary of a national bank does not violate California's Tenth Amendment rights.*"[58]

A few commenters cite *Hopkins Federal Savings & Loan Association* v. *Cleary,*[59] as support for the assertion that the 10th Amendment prohibits the federal government from interfering with a state's jurisdiction over corporations created under that state's laws. In that case, the court held that a federal statute (HOLA), which permitted the conversion of state savings associations into

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[56] *See also National City Bank of Indiana* v. *Boutris,* 2003 WL 21536818 (E.D. Cal. July 2, 2003) (also enjoining California officials from exercising visitorial powers over a national bank operating subsidiary); *Budnik supra* note 45, at 5–7 citing the *Wells Fargo* case with approval.

Moreover, the Office of Thrift Supervision (OTS) takes the same approach with respect to operating subsidiaries of federal thrifts that we take for national banks. 12 CFR 559.3(n) of the OTS regulations provides that state law applies to federal savings associations' operating subsidiaries to the extent that the law applies to the parent thrift. This OTS regulation has been upheld by both federal and state courts. *See WFS Financial Inc.* v. *Dean,* 79 F. Supp. 2d 1024 (W.D. Wis. 1999); *see also Chaires* v. *Chevy Chase Bank, F.S.B.,* 748 A.2d 34, 44 (Md. App. 2000).

[57] 12 CFR 7.4006.

[58] *Wells Fargo,* 265 F. Supp. 2d at 1170, (citing *M'Culloch,* 17 U.S. at 424–25 and *First Union Nat'l Bank,* 48 F. Supp. 2d at 148 (emphasis added). *See also Nat'l City Bank of Indiana,* 2003 WL 21536818 at 3 and 4.

[59] 296 U.S. 315 (1935).

federal savings associations notwithstanding state law to the contrary, was unconstitutional because it conflicted with the 10th Amendment.

The essence of the *Hopkins* case was that Congress had attempted to confer rights on a state-chartered entity that were greater than those conferred by the state, namely a more liberal voting requirement for a conversion. As stated by the *Hopkins* Court, "[t]he critical question [was] whether along with such a power [of the U.S. Congress to create federal building and loan associations] there goes the power also to put an end to corporations created by the states and turn them into different corporations created by the nation."[60] The Court's characterization of the issue highlights the distinction between the state-chartered building and loan associations in the *Hopkins* case and national bank operating subsidiaries. The Court found the law—unconstitutionally—attempted to displace a preexisting state interest by permitting the abandonment of a state bank charter notwithstanding contrary state law. After discussing why the state should retain the right to determine when and how a state thrift is dissolved, the court noted that it would be "an intrusion for another government to regulate by statute or decision, *except when reasonably necessary for the fair and effective exercise of some other and cognate power explicitly conferred.*"[61]

Hopkins is thus factually inapposite for two reasons. First, nothing in this final rule addresses changes in charter type or *corporate* status by state-chartered entities. Second, as we have explained, once it is established or acquired, a national bank operating subsidiary is a means by which the national bank exercises federally authorized powers. The operating subsidiary conducts its activities pursuant to a license granted under OCC regulations, which also constitutes a federal "license" under the Administrative Procedure Act.[62] In contrast to the state-chartered thrift institutions in *Hopkins,* its operation and activities are thus properly within the purview of federal regulation.[63]

Later, the Court stated "[w]e are not concerned at this time with the applicable rule in situations where the central government is at liberty *(as it is under the commerce clause when such a purpose is disclosed)* to exercise a power that is exclusive as well as paramount . . . . *No question is here as to the scope . . . of the power to regulate transactions affecting interstate or foreign*

[60] *Id.* at 336.

[61] *Id.* at 337 (emphasis added).

[62] Under the Administrative Procedure Act, federal agencies may grant licenses after following certain procedures. 5 USC 558(c). National banks must comply with licensing requirements contained in 12 CFR 5.34(b) in order to establish or acquire an operating subsidiary. These requirements are consistent with the Administrative Procedure Act.

[63] Where a state entity is not within the purview of federal regulation, the OCC's rules require consideration of state law before any approval or changes in corporate form. For example, where a state-chartered nonbank affiliate of a national bank wishes to merge with a national bank (with the resulting entity being a national bank), the law of the state in which the nonbank affiliate is organized must permit the state entity to engage in the merger. *See* 12 CFR 5.33(g)(4)(i) as set forth in a final rule published on December 17, 2003, 68 FR 70122.

commerce."[64] Thus, *Hopkins* explicitly does not address the limits of state and federal government authority, respectively, when a state corporation is engaged in activities that are carried out under federal law subject to federal authority.

Case law since *Hopkins* has clarified the interplay between the 10th Amendment and the Commerce Clause. As noted by the Supreme Court in *United States* v. *Lopez,* 514 U.S. 549 (1995), the Supreme Court in the first half of the 19th century viewed the Commerce Clause as a limit on state legislation that discriminated against interstate commerce. Now, however, the Commerce Clause is viewed more as a grant of authority to Congress. *Id.* at 556. That power has its limits; it "may not be extended so as to embrace effects upon interstate commerce so indirect and remote that to embrace them, in view of our complex society, would effectually obliterate the distinction between what is national and what is local and create a completely centralized government." *Id.* at 557, quoting *NLRB* v. *Jones & Laughlin Steel Corp.,* 301 U.S. 1, 37 (1937). But if an activity fits within one of the categories of activity that Congress may regulate under its commerce power,[65] or other Constitutional authority, the regulation will be upheld.

This year the U.S. Supreme Court affirmed *per curiam* that the Commerce Clause permits Congress to regulate activity affecting intrastate lending. In *Citizens Bank* v. *Alafabco Inc.,* 123 S. Ct. 2037 (2003), the Court found that a debt restructuring agreement, involving a national bank located in Alabama and an Alabama corporation, had a sufficient nexus with interstate commerce to make an arbitration provision in that agreement enforceable under the Federal Arbitration Act, 9 USC 2. The Court stated, "Congress' Commerce Clause power 'may be exercised in individual cases without showing any specific effect upon interstate commerce' if in the aggregate the economic activity in question would represent 'a general practice . . . subject to federal control.'" *Citizens Bank,* 123 S. Ct. at 2040 (emphasis in original) (citations omitted). After articulating the reasons why the debt restructuring agreements involved commerce within the meaning of the Commerce Clause, the Court stated "[n]o elaborate explanation is needed to make evident the broad impact of commercial lending on the national economy or Congress' power to regulate that activity pursuant to the Commerce Clause."[66]

Clearly, national bank operating subsidiaries, licensed by the OCC, engaging in activities permissible for their parent national banks and subject to the same terms and conditions are on the same

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[64] *Id.* at 338, 343 (emphasis added) (citations omitted).

[65] Those categories were articulated in *Lopez* as follows: "First, Congress may regulate the use of the channels of interstate commerce. Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities. Finally, Congress' commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce, *i.e.,* those activities that substantially affect interstate commerce." *Id.* at 558–59 (citations omitted).

[66] *Citizens Bank,* 123 S. Ct. 2041. *See also Lewis* v. *BT Investment Managers, Inc.,* 447 U.S. 27, 38–39 (1980) ("[B]anking and related financial activities are of profound local concern . . . . Nonetheless, it does not follow that these same activities lack important interstate attributes"); *Perez* v. *United States,* 402 U.S. 146, 154 (1971) ("Extortionate credit transactions, though purely intrastate, may in the judgment of Congress affect interstate commerce").

footing for purposes of the 10th Amendment. Given that they, like their parent banks, engage in activities that have a substantial effect on interstate commerce, regulation of the subsidiaries' activities would be within Congress' authority under the 10th Amendment.

E. Description of the Final Rule

Based upon the foregoing discussion and analysis, the OCC has adopted the final rule with certain modifications that do not alter the fundamentals of the rule as proposed. We have amended the language in § 7.4000(a)(3) slightly to simplify it. In addition, we have amended the regulation text in the final rule in § 7.4000(b)(2). This provision no longer makes reference to the specific powers of the courts of justice "to issue orders or writs compelling the production of information or witnesses" since this is implicit. In addition, we have simplified the language which states that the exception for courts of justice does not authorize states or other governmental entities to exercise visitorial powers over national banks.

F. Regulatory Analysis

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 USC 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. Accordingly, a regulatory flexibility analysis is not needed. The amendments to the regulations simply identify the scope of activities for which the agency's visitorial powers are exclusive and clarify how an exception to such powers applies. These amendments do not impose any new requirements or burdens. As such, they will not result in any adverse economic impact.

Executive Order 12866

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

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104–4 (2 USC 1532) (Unfunded Mandates Act), requires that an 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 an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a 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, this rulemaking is not subject to section 202 of the Unfunded Mandates Act.

Executive Order 13132

Executive Order 13132, titled "Federalism," (Order) requires federal agencies, including the OCC, to certify their compliance with that Order when they transmit to the Office of Management and Budget 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 consultation requirements with state and local officials; requires publication in the preamble of a federalism summary impact statement; and requires the OCC to make available to the Director of the Office of Management and Budget any written communications submitted by state and local officials. By the terms of the Order, these requirements apply to the extent that they are practicable and permitted by law and, to that extent, must be satisfied before the OCC promulgates a final regulation.

In the proposal, we noted that the regulation may have federalism implications. It is not clear that the Order applies in situations where an agency is implementing a statute that has preemptive effect. Nevertheless, in formulating the proposal and the final rule, the OCC has adhered to the fundamental federalism principles and the federalism policymaking criteria.

Moreover, the OCC has satisfied the requirements set forth in the Order for regulations that have federalism implications and preempt state law. The steps taken to comply with these requirements are set forth below.

- *Consultation.* The Order requires that, to the extent practicable and permitted by law, no agency shall promulgate any regulation that has federalism implications and that preempts state law unless, prior to the formal promulgation of the regulation, the agency consults with state and local officials early in the process of developing the proposed regulation. We have consulted with state and local officials on the issues addressed herein through the rulemaking process. Following the publication of the proposed rule, representatives from the Conference of State Bank Supervisors (CSBS) met with the OCC to clarify their understanding of the proposal and, subsequently, the CSBS submitted a detailed comment letter regarding the proposal. Thirty-two additional comments were also submitted on the proposal by other state and local officials and state banking regulators. Pursuant to the Order, we will make these comments available to the Director of the OMB. Subsequent public statements by representatives of the CSBS have restated their concerns, and CSBS representatives have further discussed these concerns with the OCC on several additional occasions.

The Order requires a federalism summary impact statement which addresses the following in addition to the consultation discussed above:

- *Nature of concerns expressed.* The Order requires a summary of the nature of the concerns of the state and local officials and the agency's position supporting the need to issue the regulation. The nature of the state and local official commenters' concerns and the OCC's position supporting the need to issue the regulation are set forth in the preamble, but may be summarized as follows. Broadly speaking, the states disagree with our interpretation of the applicable law, they are concerned about the impact the proposal will have on the dual banking system, and they are concerned about the ability of the OCC to protect consumers adequately.

- *Extent to which the concerns have been addressed.* The Order requires a statement of the extent to which the concerns of state and local officials have been met. The concerns are addressed in order.

  a. There is fundamental disagreement between state and local officials and the OCC regarding the meaning of section 484 as well as the Congressional intent behind the statute. The nature of the disagreement is discussed at length in the materials that precede this federalism impact statement. For the reasons set forth in those materials, we believe that the language of section 484, its legislative history, and the application of that section by courts lead to the conclusion that the OCC has exclusive visitorial authority to enforce applicable state laws. The concerns of the state and local officials could only be fully met if the OCC were to take a position that is contrary to the express provisions of the statute and judicial precedent. Nevertheless, to respond to some of the issues raised, the language in the final regulation has been refined, and this preamble further explains that the OCC's visitorial powers are exclusive with respect to the federally authorized banking business of national banks.

  b. Similarly, we fundamentally disagree with the state and local officials about whether this proposal will undermine the dual banking system. As set forth in the preamble, differences in national and state bank powers and in the supervision and regulation of national and state banks are not inconsistent with the dual banking system; rather they are the defining characteristics of it. The dual banking system is universally understood to refer to the chartering and supervision of state-chartered banks by state authorities and the chartering and supervision of national banks by federal authority, the OCC. Thus, we believe that the final rule preserves, rather than undermines, the dual banking system.

  c. Finally, we stand ready to work with the states in the enforcement of applicable laws. The OCC has extended invitations to state Attorneys General and state banking departments to enter into discussions that would lead to a memorandum of understanding about the handling of consumer complaints and the pursuit of remedies, and we remain eager to do so.

We believe the OCC has the resources to enforce applicable laws, as is evidenced by the enforcement actions that have generated hundreds of millions of dollars for consumers in restitution, that have required national banks to disassociate themselves from payday lenders, and that have ordered national banks to stop abusive practices. These actions are listed on the OCC's website at *http://www.occ.treas.gov/enforce/enf_search.htm*. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, in an action brought by Arizona against a national bank, among others, the restitution and remedial action ordered by the OCC in that matter against the bank was "comprehensive and significantly broader in scope that that available through [the] state court proceedings." *State of Arizona* v. *Hispanic Air Conditioning and Heating, Inc.,* CV 2000–003625, Ruling at 27, Conclusions of Law, paragraph 50 (Aug. 25, 2003). Thus, the OCC has ample legal authority and resources to ensure that consumers are adequately protected.

List of Subjects in 12 CFR Part 7

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

Authority and Issuance

For the reasons set forth in the preamble, the OCC amends part 7 of chapter I of title 12 of the Code of Federal Regulations as follows:

PART 7—BANK ACTIVITIES AND OPERATIONS

- *1. The authority citation for part 7 continues to read as follows:*

Authority: 12 USC 1 *et seq.,* 71, 71a, 92, 92a, 93, 93a, 481, 484, 1818.

Subpart D—Preemption

- *2. In § 7.4000:*
- *a. Add a new paragraph (a)(3); and*
- *b. Revise paragraph (b) to read as follows:*

§ 7.4000 Visitorial powers.

(a) * * *

(3) Unless otherwise provided by federal law, the OCC has exclusive visitorial authority with respect to the content and conduct of activities authorized for national banks under federal law.

(b) *Exceptions to the general rule.* Under 12 USC 484, the OCC's exclusive visitorial powers are subject to the following exceptions:

(1) *Exceptions authorized by federal law.* National banks are subject to such visitorial powers as are provided by *federal* law. Examples of laws vesting visitorial power in other governmental entities include laws authorizing state or other *federal* officials to:

(i) Inspect the list of shareholders, provided that the official is authorized to assess taxes under state authority (12 USC 62; this section also authorizes inspection of the shareholder list by shareholders and creditors of a national bank);

(ii) Review, at reasonable times and upon reasonable notice to a bank, the bank's records solely to ensure compliance with applicable state unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with those laws (12 USC 484(b));

(iii) Verify payroll records for unemployment compensation purposes (26 USC 3305(c));

(iv) Ascertain the correctness of *federal* tax returns (26 USC 7602);

(v) Enforce the Fair Labor Standards Act (29 USC 211); and

(vi) Functionally regulate certain activities, as provided under the Gramm–Leach–Bliley Act, Pub. L. 106–102, 113 Stat. 1338 (Nov. 12, 1999).

(2) *Exception for courts of justice.* National banks are subject to such visitorial powers as are vested in the courts of justice. This exception pertains to the powers inherent in the judiciary and does not grant state or other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for national banks under *federal* law.

(3) *Exception for Congress*. National banks are subject to such visitorial powers as shall be, or have been, exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

Dated: January 6, 2004

John D. Hawke, Jr.
Comptroller of the Currency

Questions and Answers on the Preemption Rulemaking

January 7, 2004

I. INTRODUCTION

What action is the OCC taking today?

The OCC is issuing a final rule amending its regulations to add provisions clarifying the applicability of state law to national banks' lending, deposit-taking, and other operations. The final rule identifies types of state laws that are preempted by federal law and therefore not applicable to national banks. Most of these laws have already been found to be preempted by a federal court, the OCC, or the Office of Thrift Supervision in its comparable rules applicable to federal thrifts.[1]

In addition, the final rule identifies types of state laws that are not preempted. These types of laws generally create the legal infrastructure that enables or facilitates the exercise of a federal banking power.

Along with these preemption provisions, we are also adopting important new anti-predatory-lending standards governing national banks' lending activities—nationwide.

What action is the OCC not *taking today?*

The OCC is not authorizing any new national bank activities or powers, such as the ability to engage in real estate brokerage.

In addition, although we believe the statute authorizing national banks' real estate lending activities (12 USC § 371) could permit the OCC to occupy the field of national bank real estate lending through regulation, we have declined to announce such a position in the final rule.

Finally, the final rule makes no changes to the OCC's rules governing the activities of operating subsidiaries. As already set out in 12 CFR 5.34, 7.4006, and 34.1(b), national bank operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent banks. Therefore, *by virtue of regulations already in place*, the final rule applies equally to national banks and their operating subsidiaries.

What types of state laws will be preempted under the final rule?

The final rule sets out types of state statutes that are preempted in the areas of real estate lending, other lending, and deposit-taking. For lending, they include licensing laws, laws that address the

[1] See attached chart comparing the OCC's regulations with the regulations of the OTS and NCUA.

terms of credit, permissible rates of interest, escrow accounts, and disclosure and advertising. For deposit-taking (in addition to laws dealing with disclosure requirements and licensing and registration requirements), they include laws that address abandoned and dormant accounts, checking accounts, and funds availability. These lists reflect OCC opinions, court decisions, comparable rules applicable to federal thrifts, and the application of traditional, judicially recognized standards of preemption. These lists are not intended to be exhaustive—the OCC may identify, and address on a case-by-case basis, other types of state laws that are preempted.

In addition, with regard to bank operations, the final rule states that except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's exercise of powers granted under federal law do not apply to national banks. This provision applies to any national bank power or aspect of a national bank's powers that is not covered by another OCC regulation specifically addressing the applicability of state law.

What types of state laws will **not** *be preempted under the final rule?*

The final rule also sets out examples of the types of state laws that are *not* preempted and would be applicable to national banks to the extent that they only incidentally affect the lending, deposit-taking, or other operations of national banks. These include laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts. In addition, any other law that the OCC determines to only incidentally affect national banks' lending, deposit-taking, or other operations would not be preempted under the final rule.

What changes have been made in the final rule that differ from the proposal?

The final rule makes several changes to the anti-predatory-lending standard. First, the final rule revises the anti-predatory-lending standard so that it expressly prohibits national banks from engaging in unfair and deceptive trade practices under Section 5 of the Federal Trade Commission (FTC) Act in making any loans. In addition, the final rule revises the anti-predatory-lending standard to clarify that it applies to consumer loans only (those for personal, family, and household purposes). Finally, it clarifies that the anti-predatory-lending standard is not intended to prohibit legitimate collateral-based loans, such as reverse mortgages, where the borrower understands that it is likely or expected that the collateral will be used to repay the debt.

The final rule states that except where made applicable by federal law, state laws that "obstruct, impair, or condition" a national bank's exercise of powers granted under federal law do not apply to national banks. These terms, which are drawn directly from Supreme Court precedents, differ somewhat from the wording in the proposal, but the substantive effect—which is to encapsulate the preemption standards used by the Supreme Court—is the same.

The lists of the types of state laws that are and are not preempted in the final rule are substantially the same as the lists in the proposal.

II. REASONS AND AUTHORITY FOR THIS RULE

Why is the OCC taking this action now?

Markets for credit, deposits, and many other financial products and services are now national, if not international, in scope, as a result of technological innovations, erosions of legal barriers, and our increasingly mobile society. These changes mean that now, more than ever, the imposition of an overlay of state and local standards and requirements on top of the federal standards to which national banks already are subject, imposes excessively costly, and unnecessary, regulatory burdens.

In recent years, this burden has been getting worse, as states and localities have increasingly tried to apply state and local laws to national bank activities that are already subject to federal regulation, curtailing national banks' ability to conduct operations to the full extent authorized by federal law.

These state and local laws—including laws regulating fees, disclosures, conditions on lending, and licensing—have created higher costs, potential litigation exposure, and operational challenges. As a result, national banks must absorb the costs, pass the costs on to consumers, or discontinue offering various products in jurisdictions where the costs or exposure to uncertain liabilities are prohibitive.

When national banks are unable to operate under uniform, consistent and predictable standards, their business suffers, which negatively affects their safety and soundness. This rulemaking will enable national banks to exercise fully their federal powers pursuant to uniform standards, applied by the OCC. As a result, national banks will be able to operate with more predictability and efficiency, consistent with the national character of the national banking system, and in furtherance of the safe and sound operations of all national banks.

What authorizes the OCC to issue the final rule?

The OCC's authority to issue the preemption regulation comes from both 12 USC § 93a (for all activities) and 12 USC § 371 (specifically relating to real estate lending). In *CSBS* v. *Conover*, the D.C. Circuit expressly held that the Comptroller has the authority under § 93a to issue regulations preempting state laws that are inconsistent with the activities permissible under federal law for national banks and under § 371 to issue a regulation that preempts aspects of state laws regarding real estate lending.[2]

[2] *CSBS* v. *Conover,* 710 F.2d 878 (D.C. Cir. 1983).

Does the OTS have broader authority under the Home Owners' Loan Act to preempt the application of state laws to federal thrifts than the OCC has for national banks?

No. While the Home Owners' Loan Act (HOLA) uses a different formulation to describe the authority of the OTS, we believe those differences are not material for purposes of our rulemaking authority.

The HOLA directs the OTS to "provide for the examination, safe and sound operation, and regulation of savings associations," and authorizes the OTS to issue "such regulations as the Director determines to be appropriate to carry out the responsibilities of the Director or the Office." Elsewhere, the HOLA states that the Director is authorized "to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as Federal savings associations and to issue charters therefore, giving primary consideration of the best practices of thrift institutions in the United States."

The National Bank Act, at 12 USC § 93a, states that, "Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office, except that the authority conferred by this section does not apply to section 36 of this title [governing branching] or to securities activities of National Banks under the Act commonly known as the 'Glass–Steagall Act.'"

In addition to the general authority vested by section 93a, other statutes vest the OCC with authority to issue regulations to implement a specific statutory grant of authority. For instance, 12 USC § 371 vests the OCC with the authority to impose "restrictions and requirements" on national banks' authority to make real estate loans. The general rulemaking authority vested in the OCC by section 93a, coupled with the more specific grants of authority in section 371 and elsewhere, provide the OCC with rulemaking authority that is comparably broad to that of the OTS.

Won't the OCC's preemption rule have the effect of giving national banks a competitive advantage over state-chartered institutions?

Our actions are part of the OCC's ongoing effort to ensure that national banks are able to meet the needs of their communities in the most effective and efficient manner possible. As part of that effort, we periodically see a need to respond to attempts by states and municipalities to regulate the exercise of federal powers permitted under the National Bank Act.

States remain free to be the laboratories of change that have led to many significant improvements in the delivery of financial products and services. Each of us is responsible for ensuring that the institutions we regulate remain financially strong and competitive. However, when the states act in a way that conflicts with the powers granted to national banks by federal law, the Supremacy Clause of the United States Constitution dictates that the state law is preempted.

III. PREEMPTION STANDARDS

Is the OCC occupying the field with regard to national banks' real estate lending activities?

No. Part 34 of our rules implements 12 USC § 371, which provides a broad grant of authority to national banks to engage in real estate lending. The only qualification in the statute is that these federal powers are subject "to section 1828(o) of this title [which requires the adoption of uniform Federal safety and soundness standards governing real estate lending] and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."

As originally enacted, § 371 contained a limited grant of authority to national banks to engage in real estate lending. Over the years, Congress broadened § 371, giving the OCC the wide-ranging regulatory authority it has today. While we believe the history of § 371 indicates that Congress left open the possibility that the OCC would occupy the field of national bank real estate lending through regulation, the OCC has not exercised the full authority inherent in § 371 in the final rule. Thus, in the proposal, we invited comment on whether it would be appropriate to assert occupation of the entire field of real estate lending.

Upon further consideration of this issue and careful review of comments submitted pertaining to this point, we have concluded that the effect of such labeling is largely immaterial, and thus we decline to attach a particular label to the approach reflected in the final rule. We rely on our authority under both §§ 93a and 371, and to the extent that an issue arises concerning the application of a state law not specifically addressed in the final regulation, we retain the ability to address those questions through interpretation of the regulation, issuance of orders pursuant to our authority under § 371, or, if warranted by the significance of the issue, by rulemaking to amend the regulation.

How does the preemption standard included in the final rule—"obstruct, impair, or condition"—fit with the United States Supreme Court precedents?

The preemption standard in the final rule is a distillation of the many preemption standards applied by the Supreme Court over the years. These include "obstruct," "stands as an obstacle to," "impair the efficiency of," "condition the grant of power," "interfere with," "impair," "impede," and so on. Courts have recognized that no one phrase necessarily captures the full range of conflicts that will lead to a preemption of state law. We are not applying a standard that is inconsistent with those applied by the Supreme Court. Rather, we are adopting a standard that captures the essence of the tests used in various Supreme Court decisions. The preamble to the final rule expressly states that we are not trying to create a standard different from what the Court has expressed.

Is the final rule consistent with the standards of the Riegle–Neal Act, where Congress endorsed the application of state laws to national banks?

Yes. The Riegle–Neal Act sorted out *which* state's laws—host state or home state—regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, would apply to interstate branches of national banks, and provided that the host state's laws in those areas would apply to national banks *"except when Federal law preempts the application of such State laws to a national bank."* Potential preemption of state laws thus was expressly recognized as possible in the Riegle–Neal legislation itself.

Legislative history of the Riegle–Neal Act indicates that Congress expected the OCC to apply traditional, recognized preemption standards in deciding preemption issues, which is exactly what the OCC is doing.

The Riegle–Neal Act also specifically provided that the provisions of any state law to which a branch of a national bank is subject under the Act *"shall be enforced, with respect to such branch, by the Comptroller of the Currency."*

IV. IMPACT ON THE DUAL BANKING SYSTEM

What impact will this rule have on the dual banking system?

This rule will enhance the dual banking system. This system refers to the chartering, powers, and supervision of state-chartered banks by state authorities and the chartering, powers, and supervision of national banks by federal authority, the OCC. By its very nature, the dual banking system represents and embraces differences in national and state bank powers and in the supervision and regulation of national and state banks.

One of the key differences between national and state banks is that national banks operate pursuant to a federal grant of national bank powers, subject to uniform national standards, administered by a federal regulator. Preemption is a key principle that enables national banks to operate nationwide, under uniform national standards, subject to the oversight of a federal regulator, just as Congress intended it. This distinction between national and state banks is one of the defining characteristics of the dual banking system.

The national and state charters each have their own distinct advantages. But many national banks engage in multi-state businesses that require the efficiency of a uniform, nationwide system of laws and regulations. Customers of national banks enjoy protections that are as strong as—and in some cases stronger than—those available to customers of state banks. But they also benefit from the efficiencies of the national banking system, which lead to lower costs and expanded product offerings. It is important to remember that the dual banking system offers American consumers a choice—those who believe the state system offers greater protections can vote with their pocketbooks.

V. IMPACT ON CONSUMERS

Isn't federal preemption of state laws inconsistent with consumer protection?

Absolutely not. Today's action is fully consistent with the twin goals of promoting consumer protection and ensuring a safe, sound, and competitive national banking system. Because of the Supremacy Clause of the U.S. Constitution, many state standards do not apply to national banks. The OCC's action will not leave a void, but instead promote consumer protections for customers of national banks.

Rather than being subject to varying state standards, when they exist, under the new OCC regulations, all national banks and their operating subsidiaries are made subject to uniform, consistent, and predictable rules of fair conduct wherever they do business throughout the United States. National banks and their operating subsidiaries are subject to comprehensive supervision, OCC-administered supervisory standards (for example to prevent predatory, unfair, or deceptive lending practices), and vigorous and effective enforcement of these consumer protection laws, rules, and standards. The OCC's new regulations and supervisory approach offer real benefits to consumers. State consumer protection laws, by contrast, cannot effectively protect consumers in a similarly comprehensive, uniform, or nationwide basis.

As a result of the OCC's regulations, consumers will benefit from consistent, comprehensive protection against predatory, unfair, or deceptive lending practices, regardless of the state in which they live, *when they do business with a national bank or national bank operating subsidiary*. The OCC's recent actions also are complementary to state protection of consumers who deal with state-regulated lenders: while customers of national banks will be protected under the uniform federal consumer protections adopted by the OCC, customers of state-regulated lenders will continue to be protected to the extent that consumer protection laws exist in their home state that apply to their transactions.

Predatory lending is said by many to be an inherently local issue. Why is a national standard better in this area? Aren't states in a better position than is the OCC to understand the problems consumers encounter with abusive lending practices and, therefore, better able to fashion responses that are tailored to particular problems?

If taken to its logical conclusion, this position would lead to the regulation of abusive lending practices at the municipal level. However, many state anti-predatory-lending laws—such as the Georgia Fair Lending Act—prohibit municipalities from regulating in areas covered by the state law. In this way, a state is able to avoid subjecting institutions within its jurisdiction to inconsistent obligations, an objective shared by the OCC for national banks.

In the few instances where national banks have engaged in abusive lending practices, the problems have been specific to the bank in question and were not prevalent throughout a geographic region. Thus, we believe it is appropriate to focus on a given institution's lending practices to determine whether there are problems that require attention. This bank-specific focus, against the backdrop of an extensive array of federal consumer protections, enables the OCC to identify and respond to consumer problems when they arise.

To the extent that it is a local issue, it is worth remembering that the OCC's examination staff of more than 1,800 is housed in field offices in every state in the country and on-site in our largest banks, giving us a very strong local presence.

How do the OCC's new regulations protect consumers?

First, the OCC regulations *prohibit* a national bank from making *any* consumer loan —including any form of mortgage loan, automobile loan, and student loan—that is based predominantly on the bank's expectation that it will be repaid through foreclosure or liquidation of collateral that the consumer used to secure the loan. This rule targets a fundamental characteristic of predatory lending—lending to consumers who cannot be expected to be able to make the payments required under the terms of the loan, and will be effective in ensuring that home equity stripping, auto title lending, and other forms of abusive credit practices that injure individual consumers and communities will not occur in the national banking system.

As a result of this regulation, national banks are subject to the most comprehensive federal anti-predatory-lending standard in existence today: unlike the Home Ownership and Equity Protection Act (HOEPA), the OCC rules are not limited to "high cost" home mortgages, but instead apply to all types of consumer loans and mortgages made by national banks. Consequently, they will have a substantially broader reach than not only HOEPA, but also state predatory lending laws.

Second, the OCC regulations also explicitly prohibit a national bank from engaging in unfair or deceptive practices that violate the Federal Trade Commission Act (FTC Act) in connection with any consumer loan, including mortgages. While the OCC does not have the authority under the Federal Trade Commission Act to adopt rules defining particular acts or practices as unfair or deceptive under that act (that authority is only conferred on the Federal Reserve Board), we do have authority to take enforcement action where we find unfair or deceptive practices. OCC case-by-case enforcement actions under the FTC Act have had a real and meaningful impact on correcting abuses and helping consumers by providing hundreds of millions of dollars in restitution to consumers who have been harmed by unfair, deceptive, or abusive lending practices. The OCC's new regulations provide greater clarity to the application of this prohibition to all lending by national banks and their operating subsidiaries.

What federal consumer protection standards apply to national banks and national bank operating subsidiaries in the absence of state laws?

National banks and national bank operating subsidiaries are subject to extensive federal consumer protection laws and regulations, administered and enforced by the OCC. OCC examinations of national banks and national bank operating subsidiaries are conducted to ensure and enforce compliance with these laws and regulations, and supplemental OCC supervisory standards. Federal consumer protection laws and regulations that apply to national banks and to national bank operating subsidiaries include the following:

- Federal Trade Commission Act
- Truth in Lending Act
- Home Ownership and Equity Protection Act
- Fair Housing Act
- Equal Credit Opportunity Act
- Real Estate Settlement Procedures Act
- Community Reinvestment Act
- Truth in Savings Act
- Electronic Fund Transfer Act
- Expedited Funds Availability Act
- Flood Disaster Protection Act
- Home Mortgage Disclosure Act
- Fair Housing Home Loan Data System
- Credit Practices Rule
- Fair Credit Reporting Act
- Federal privacy laws
- Fair Debt Collection Practices Act
- OCC anti-predatory-lending rules in Parts 7 and 34
- OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements
- OCC standards on unfair and deceptive practices (http://www.occ.treas.gov/ftp/advisory/2002-3.doc.)

- OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions (http://www.occ.treas.gov/ftp/advisory/2003-2.doc. and http://www.occ.treas.gov/ftp/advisory/2003-3.doc.)

What will protect consumers who receive real estate loans from national banks now that various state laws are preempted?

Consumers will continue to be protected by an extensive array of federal protections, enforced by the OCC (see above). Preemption of state laws governing national banks' real estate lending certainly *does not* mean that such lending would be unregulated. On the contrary, national banks' real estate lending is highly regulated under federal standards and subject to comprehensive supervision. In addition to the many standards that apply to national banks under various federal laws, the OCC recently issued comprehensive supervisory standards to address predatory and abusive lending practices, OCC Advisory Letter 2003–2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices" and OCC Advisory Letter 2003–3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans."

Moreover, the final rule adds an explicit safety-and-soundness–based anti-predatory-lending standard to the general statement of authority concerning lending. The regulation states that a national bank shall not make a consumer loan subject to 12 CFR part 34 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources. The regulation further provides that, in making any real estate loan, a national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act and regulations promulgated thereunder. As described in the preamble to the regulation, the OCC's pioneering commitment to using the FTC Act to address consumer abuses is demonstrated by a number of recent actions against national banks that have resulted in the payment of hundreds of millions of dollars in restitution to consumers.

The new anti-predatory-lending standard and the multitude of other existing federal laws such as the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), and the Equal Credit Opportunity Act (ECOA), ensure that national banks are subject to consistent and uniform federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety-and-soundness–based criteria for their real estate lending activities.

What does the rule mean for consumer protection in non–real estate loans?

The final rule regarding non–real estate lending contains the same safety-and-soundness–based anti-predatory-lending standard included in the real estate lending portion of the final rule. Together, this new prudential standard, and federal laws such as TILA and the FTC Act, ensure that national banks are subject to consistent and uniform federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety-and-soundness–based criteria for their lending activities.

How does the OCC supervise national banks and national bank operating subsidiaries for compliance with consumer protection laws and standards?

The OCC supervises national banks' compliance with consumer protection laws and anti-predatory-lending standards through programs of ongoing supervision that are tailored to the size, complexity, and risk profile of different types of banks, and through targeted enforcement actions. National banks and national bank operating subsidiaries are subject to comprehensive—and, in the case of the largest banks, *continuous*—supervision. With a network of approximately 1,800 examiners, the OCC conducts risk-based examinations of national banks and national bank operating subsidiaries throughout the United States. Thus, for example, whether a national bank conducts its mortgage lending business in a department of the bank, in a branch, or in an operating subsidiary, OCC supervision focuses on that line of business wherever and however the bank conducts it.

The OCC's Customer Assistance Group (CAG) in Houston, Texas, also plays an important role in helping to identify potential violations of consumer protection law and unfair or deceptive practices. CAG provides immediate assistance to consumers and also collates and disseminates complaint data that help direct OCC examination resources to banks, activities, and products that present compliance risks and that require further investigation. In addition to information obtained in on-site examinations and through consumer complaints, the OCC evaluates information about abusive lending and illegal practices by national banks and their subsidiaries that it obtains from other sources, including community organizations and state enforcement agencies.

Where violations of law are found, the OCC takes appropriate action to remedy the problem and to address consumer harm. In this regard, the OCC is the first and only federal banking agency to take action to combat unfair and deceptive lending practices by enforcing the Federal Trade Commission Act. For example, the OCC recently entered into a consent agreement with a bank that the OCC concluded had engaged in predatory mortgage lending practices, including making a loan without regard to the borrower's ability to repay the loan, "equity stripping," and "fee packing." *See* "In the Matter of Clear Lake National Bank, San Antonio, TX," Enforcement Action 2003–135 (November 6, 2003), available at http://www.occ.treas.gov/ftp/eas/ea2003-135.pdf. No other federal banking agency has taken enforcement action to address predatory mortgage lending or deceptive marketing practices affecting subprime borrowers. The OCC's enforcement actions have provided over $300 million in restitution thus far to consumers of modest means and limited or impaired credit histories who have been harmed by abusive practices.

It also is our hope that states will cooperate with the OCC to try to maximize the protection of consumers. If the states and the OCC work together, we can leverage all of our resources to combat abusive financial providers. The OCC has adopted special procedures to expedite referrals of consumer complaints regarding national banks from state Attorneys General and state banking departments, and we have offered to enter into formal information-sharing agreements with states to formalize these arrangements. We recently concluded the first of these arrangements and hope that other states will soon follow suit.

How can the OCC assure that customers of national bank operating subsidiaries are adequately protected if the OCC has not provided a list of those operating subsidiaries?

The OCC supervises the activities of national banks and their operating subsidiaries based on a line of business approach, not based on the corporate form in which it is conducted. For example, the OCC will apply a comprehensive approach to supervising a bank's mortgage banking activities whether they are conducted in departments of the bank, branches, or one or more operating subsidiaries. We do not maintain an aggregate count of national bank operating subsidiaries just as we do not maintain an aggregate count of the number of departments banks use to do business. Operating subsidiary information is available to OCC supervisors at the individual bank level, is included in our supervisory data system for community and Mid-Size banks, and for Large Banks, all significant subsidiaries are listed in the quarterly risk analysis prepared by each bank's examiner-in-charge.

Most national bank operating subsidiaries use names that clearly identify them with their parent bank, thus a customer with a complaint would know they are dealing with a bank-related business and could expect that he or she could lodge the complaint by contacting the OCC's Customer Assistance Group. In some instances, however, the operating subsidiary may have a name that does not readily connect it with its parent bank. In order to better address those situations, the OCC will be establishing a link from the Consumer Assistance web page to a searchable database of national bank subsidiaries that do business directly with consumers, and that are *not* functionally regulated by other regulators. We are compiling this information from our various databases and will begin with a listing of these types of subsidiaries of our Large Banks.

The OCC's traditional mission has been to audit banks for safety and soundness. How does the OCC's preemption rule further safety and soundness?

To the extent that the question implies that preemption will result in a lack of consumer protections, we would disagree. It is not a question of whether national banks will be subject to consumer protection laws, but only a question of which laws apply. National banks are subject to a comprehensive regimen of federal consumer protection laws and regulations, including the new anti-predatory-lending standard included in this rulemaking.

We examine our banks to ensure that they are complying with these protections and, where we find that a bank is not, we take appropriate action against that bank. This approach enables us to tailor the regulatory response to the problem, rather than impose a one-size-fits-all rule that prohibits all national banks from offering certain financial products. In this way, banks are free to offer products and services that meet the needs of their customers and communities, in a manner that is consistent with safe and sound banking practices.

Questions and Answers on the Visitorial Powers Rulemaking

January 7, 2004

I. INTRODUCTION

What are "visitorial powers"?

The term "visitorial powers" refers to the power of a regulator or superintendent to inspect, examine, supervise, and regulate the affairs of an entity.

What is the effect of your recently published final rule amending your visitorial powers regulation?

The final rule clarifies two points concerning our *existing* regulation regarding the OCC's exclusive visitorial authority under 12 USC § 484. The federal statute that addresses this area, 12 USC § 484, states that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized."

Our regulation clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national bank activities authorized under federal law. In other words, the OCC is the exclusive supervisor of a national bank's banking activities; the OCC does not enforce fire codes, environmental laws, etc.

Our final rule also clarifies that the exception to the OCC's exclusive visitorial powers for "visitorial powers . . . vested in the courts of justice" in section 484 pertains to powers inherent in the judiciary and does not grant state or other governmental authorities any right that they do not otherwise possess to inspect, superintend, direct, regulate, or compel compliance by a national bank with any law regarding the content or conduct of activities authorized for national banks under federal law.

What changes have been made in the final rule that differ from the proposal?

We have amended the language in § 7.4000(a)(3) to simplify it. This provision clarifies that the OCC has exclusive visitorial powers just with respect to the content and conduct of activities that are authorized for national banks under federal law.

We have also amended the regulation text in the final rule concerning the "visitorial powers . . . vested in the courts of justice" exception. This provision no longer makes reference to specific powers of the courts of justice "to issue orders or writs compelling the production of information or witnesses" since that description may be too limiting. This provision now simply states that the exception pertains to powers inherent in the judiciary. The language that stated that the exception for courts of justice does not authorize states or other governmental entities to exercise visitorial powers over national banks also has been simplified.

What does the final rule not *do?*

The rule does not prevent state officials from enforcing state laws that do not pertain to a national bank's banking activities, such as environmental laws, fire codes, zoning ordinances or criminal laws of general applicability.

The final rule makes no change to the treatment of operating subsidiaries. An existing OCC regulation, 12 CFR § 7.4006, states that "[u]nless 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." Thus, states generally can exercise visitorial powers over operating subsidiaries only to the extent that they could exercise visitorial powers over a national bank.

The final rule does not change the ability of states to seek a declaratory judgment from a court as to whether a particular state law applies to the federally authorized business of a national bank or is preempted.

II. IMPACT ON DUAL BANKING SYSTEM

Isn't the final rule inconsistent with the dual banking system?

No. The dual banking system refers to the chartering and supervision of state-chartered banks by state authorities and the chartering and supervision of national banks by federal authority, the OCC. By its very nature, the dual banking system represents and embraces differences in national and state bank powers and in the supervision and regulation of state and national banks. Dual banking does not mean that national banks are subject to state supervision or regulation of activities they are authorized to conduct under federal banking law.

Is it the case, as certain state officials suggest, that this rule would disrupt the current system under which states enforce consumer compliance laws?

No. There may have been some misunderstanding over the years about the limits of state visitorial authority. For 140 years, the national banking statutes have said that no national bank shall be subject to any visitorial powers except as authorized by federal law. Federal law—at 12 USC § 484—clearly vests the OCC with exclusive visitorial powers over the business of banking conducted by national banks. Equally clearly, courts have stated that visitorial powers include the power to enforce compliance with applicable law. With certain narrow exceptions, federal law does not grant visitorial authority over national banks to the states. In fact, in the area of consumer protection, Congress stated explicitly, in the Riegle–Neal Act, that *the OCC* enforces any state consumer protection law that applies to interstate branches of national banks.

Recent debate about enforcement has centered recently on the ability of states to enforce their laws against operating subsidiaries of national banks. Operating subsidiaries are federally authorized means through which national banks can conduct business. The only court cases to decide the issue of the OCC's visitorial authority over national bank operating subsidiaries have held that our exclusive visitorial authority—including the authority to enforce compliance with applicable law—extends to operating subsidiaries. Thus, while states are free to enforce consumer compliance laws as they apply to institutions within their primary jurisdiction, they are not free to do so in the context of national banks or their operating subsidiaries, except where federal law authorizes them to do so.

What role may states play under the final rule?

The states have a crucial role to play. It is our hope that states will cooperate with the OCC to try to maximize the protection of consumers. If the states and the OCC work together, we can leverage all of our resources to combat abusive financial providers. The OCC has adopted special procedures to expedite referrals of consumer complaints regarding national banks from state Attorneys General and state banking departments, and we have offered to enter into formal information-sharing agreements with states to formalize these arrangements. We recently concluded the first of these arrangements and hope that other states will soon follow suit.

Isn't it true that the* Household *case recently concluded by the New York Attorney General would not have been possible if the preemption rule had been in effect?

No. There have been several actions against financial entities that are within the Household corporate family. One such action was brought by the OCC, against Household Bank (SB), N.A. In that action, the court stated that "[t]he restitution and remedial action ordered by the OCC is comprehensive and significantly broader in scope than that available through these state court proceedings. The OCC Agreement [with the bank] provides significantly more relief to Arizona consumers than this Court finds a legal basis for imposing under state law."

The State of New York also recently concluded an action against Household International, the parent company of Household Finance Corporation and Beneficial Finance Corporation. Those entities are outside the jurisdiction of the OCC, and will remain so after this rule becomes effective. Thus, our actions in this rulemaking *will not affect in any way* the state's ability to bring the enforcement action in question.

III. AUTHORITY FOR THE RULE

A. National banks

On what does the OCC base its conclusion that its visitorial authority is exclusive?

Federal law. Section 484 explicitly states that "[n]o national bank shall be subject to any visitorial powers except as authorized by federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized." The statute first sets forth a complete prohibition, then subjects that prohibition to certain exceptions. In other words, the prohibition applies unless a visitorial power is covered by one of the enumerated exceptions. *None* of the exceptions in the statute allows for the allocation of any general bank supervisory responsibility to the states. Further, such an allocation to the states would be inconsistent with the history and purpose of the National Bank Act and judicial precedent interpreting the Act.

B. Operating subsidiaries

By what authority do you claim that the OCC has exclusive visitorial power over national bank operating subsidiaries?

Federal law. Pursuant to their authority under 12 USC § 24(Seventh), national banks have long used separately incorporated entities as a means to engage in activities that the bank itself is authorized to conduct. When established in accordance with OCC regulations and approved by the OCC, an operating subsidiary is a federally authorized, federally licensed means by which a national bank may conduct federally authorized activities.

Courts have consistently treated operating subsidiaries as equivalent to national banks, unless *federal* law requires otherwise. As a matter of federal law, operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent bank, including being subject to the exclusive visitorial authority of the OCC.

Courts that have considered the issue have confirmed recently that the OCC has exclusive visitorial authority over national bank operating subsidiaries. In *Wells Fargo Bank, N.A. v. Boutris*, a federal district court issued a permanent injunction enjoining the California Department of Corporations from exercising visitorial powers over a national bank operating subsidiary. The court noted the existing case law and concluded that the OCC's operating subsidiary regulation is within the agency's authority delegated to it by Congress and is a reasonable interpretation.

Didn't the Gramm–Leach–Bliley Act (GLBA) make clear that operating subsidiaries are explicitly not *to be treated as part of their parent bank?*

No, to the contrary. Section 121 of GLBA recognizes 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*." This underscores the point that an operating subsidiary is treated, for regulatory and supervisory purposes, the same as its parent bank.

Why shouldn't states have jurisdiction over entities that are created under state law—namely, operating subsidiaries?

States *do* have jurisdiction over operating subsidiaries for matters concerning the corporate existence or corporate governance of operating subsidiaries. However, the states' jurisdiction stops at the point of regulating federally authorized banking activities that the operating subsidiary conducts.

Under federal law, a national bank may exercise the federal banking powers available to it either directly in the bank or indirectly through an operating subsidiary. If the bank elects to use an operating subsidiary, the bank is required to obtain a federal license to do so pursuant to the procedures set forth in the OCC's regulations. Once the license is obtained, the activity will be subject to the same terms and conditions that would apply if the bank conducted the activity directly.

IV. IMPACT ON CONSUMERS

Why isn't it better to have more than one cop on the beat looking out for consumers? The OCC has relatively little experience in investigating banks for compliance with consumer protection laws. Why not accept help from the state Attorneys General, who have a great deal of experience in this area?

Under federal law, only the OCC can examine or bring action against a national bank. And, in fact, the system works best when we each focus on our separate jurisdictions, as was demonstrated recently by a joint action taken against Security Trust Company and three of its executives by the OCC, the New York Attorney General, and the Securities and Exchange Commission.

The OCC is well equipped to handle enforcement matters for entities within our jurisdiction. Through a network of approximately 1,800 examiners located throughout the United States, we monitor conditions and trends in individual banks and groups of banks. Our supervisory activities home in on risks identified by surveillance tools and subject matter experts. In the consumer area, consumer complaint information is used to identify potential problems in a bank's dealings with customers.

As part of our ongoing supervision of national banks, examiners look at bank policies and procedures. These policies and procedures are reviewed to evaluate if they adequately address the particular risks that the bank may face, given the nature and scope of its business. Depending on the nature of that business, we would expect bank policies and controls to reflect the considerations we have identified in our two advisories on how national banks should avoid becoming involved in predatory lending practices.

Our Customer Assistance Group (CAG) in Houston, Texas, plays an important role in helping to identify potentially unfair and deceptive practices. In addition to providing immediate assistance to consumers, the CAG collates and disseminates complaint data that help point our field examiners toward banks, activities, and products that require further investigation.

We obtain additional valuable insight and surveillance from community and consumer groups, internal and external auditors, other federal, state and local authorities, and competing banks.

Thus, national banks' compliance with applicable laws is subject to comprehensive—and in the case of the largest national banks, *continuous*—supervision. Where violations of law are found, we take appropriate action to remedy the problem and to address consumer harm.

As previously noted, it is our hope that states will cooperate with the OCC to try to maximize the protection of consumers. We have encouraged states to work with us to expedite referrals of consumer complaints regarding national banks from state Attorneys General and state banking departments, and have offered to enter into formal information-sharing agreements with states to formalize these arrangements.

Has the OCC ever brought a case charging predatory lending?

In fact, we are the first—and thus far, only—federal banking regulator to bring enforcement actions under section 5 of the Federal Trade Commission (FTC) Act against financial institutions for abusive lending practices. The most recent case, against Clear Lake National Bank, involved home equity loan terms that we considered to be unfair to consumers. We required the bank to reimburse the borrowers in question. We have brought five other cases since 2001 under the FTC Act that have led to restitution of affected consumers. Moreover, we have moved aggressively to require national banks to terminate their relationships with "payday lenders." We share the states' concerns about the impact of predatory and abusive lending practices on consumers, and have moved aggressively to stop it whenever it is located in an institution we supervise.

Even the state Attorneys General have acknowledged that it has not been a widespread problem inside the regulated banking industry. Having said that, however, the OCC has a strong track record of taking quick and decisive action against lenders that engage in abusive practices.

The OCC's traditional mission has been to audit banks for safety and soundness. How does the OCC's visitorial powers rule further safety and soundness?

To the extent that the question implies that preemption will result in a lack of consumer protections, we would disagree. It is not a question of *whether* national banks will be subject to consumer protection laws, but only a question of *which* laws apply. National banks are subject to a comprehensive regimen of federal consumer protection laws and regulations, including the new anti-predatory-lending standard included in this rulemaking.

We examine our banks to ensure that they are complying with these protections and, where we find that a bank is not, we take appropriate action against that bank. This approach enables us to tailor the regulatory response to the problem, rather than impose a one-size-fits-all rule that prohibits all national banks from offering certain financial products. In this way, banks are free to offer products and services that meet the needs of their communities, in a manner that is consistent with safe and sound banking practices.

Tables 1a and 1b: Comparison of the OCC's Preemption Rules with the Office of Thrift Supervision's and the National Credit Union Administration's Current Rules, by Type of State Laws Generally Preempted and Generally *not* Preempted

January 7, 2004

Table 1a

Types of State Laws Generally Preempted	OCC Rules	OTS Current Rules	NCUA Current Rules
Abandoned and dormant accounts (deposit-taking)	✔	✔	✔
Aggregate amount of funds that may be lent on the security of real estate	✔ *		
Checking/share accounts (deposit-taking)	✔	✔	✔
Covenants and restrictions necessary to qualify a leasehold as security property for a real estate loan	✔ *		
Access to, and use of, credit reports	✔	✔	
Terms of credit	✔ *	✔	✔
Creditor's ability to require or obtain insurance of collateral or other risk mitigants /credit enhancements	✔	✔	
Due-on-sale clauses	✔	✔	✔
Escrow, impound, and similar accounts	✔	✔	
Funds availability (deposit-taking)	✔	✔	
Interest rates	✔ **	✔	✔
Fees	✔ ***	✔	✔
Licensing, registration, filings, and reports	✔	✔	
Loan-to-value ratios	✔ *	✔	✔
Mandated statements and disclosure requirements	✔	✔	✔
Mortgage origination, processing, and servicing	✔	✔	
Disbursements and repayments	✔ *	✔	✔
Savings account orders of withdrawal (deposit-taking)	✔	✔	
Security property, including leaseholds	✔	✔	✔
Special-purpose saving services (deposit-taking)	✔	✔	

* Already preempted by the OCC's existing real estate lending regulation at 12 CFR Part 34.
** National banks' authority to charge interest is established by 12 USC § 85, and the OCC's existing regulation at 12 CFR § 7.4001.
***National banks' authority to charge fees is already addressed by the OCC's existing regulations at 12 CFR § 7.4002.

Table 1b

Types of State Laws Generally *not* Preempted	OCC Rules	OTS Current Rules	NCUA Current Rules
Contracts	✔	✔	
Commercial	✔	✔	
Torts	✔	✔	
Criminal law	✔	✔	
Homestead laws specified by federal statute	✔	✔	
Debt collection	✔		
Acquisition and transfer of real property	✔	✔	✔
Taxation	✔		
Zoning	✔		
Collections costs and attorneys' fees			✔
Plain language requirements			✔
Default conditions			✔
Insurance			✔
Incidental effect only	✔	✔	