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TESTIMONY OF

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COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Of the

U.S. SENATE

April 7, 2004

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, I appreciate this opportunity to address the OCC's recent rulemakings pertaining to the applicability of State laws to national banks. Federal preemption of State law is a subject that touches on fundamental characteristics of the national bank charter, fundamental responsibilities of the OCC, the essential attributes of this country's dual banking system, and how the interests of customers are served by the national banking system and protected by the OCC.

I welcome the opportunity to explain how our rules further the longstanding purposes of the national banking laws to ensure that national banks operate pursuant to a uniform set of nationwide standards; how they reinforce and reaffirm the high standards of integrity and fair treatment of customers that we expect of national banks; and how they preserve the distinct roles of Federal and State regulators that define our dual banking system. I should emphasize that these rules resulted from a process the OCC began in 2002, by discussing with consumer groups, members of Congress and their staffs, and industry groups, the need for regulations to codify well-established preemption precedents and clarify the regulations implementing the statute governing the OCC's exclusive visitorial powers. The actions that we ultimately determined to take are grounded in the existing law, are not dramatic departures from existing preemption precedents and principles recognized for Federally chartered institutions, and were taken in accordance with established, formal rulemaking processes.

In reviewing these rules, particularly as they affect State anti-predatory lending laws, it is important not to lose sight of three fundamental points:

- National banks are highly regulated and closely supervised. There is no evidence that they are the source of predatory lending practices.
- The OCC is committed to protecting customers of national banks; where problems have arisen, our track record shows that we will act to fix them.
- We welcome opportunities to enhance information sharing and collaboration with the States to address customer complaints and consumer protection issues.

My written statement, which addresses these points in greater detail, covers four areas. I will begin by describing briefly what our new rules do, and, in order to address some confusion that exists, what they do *not* do. Second, I will describe the actions the OCC has taken to ensure that customers of national banks are not subject to unfair, deceptive, abusive or predatory practices. Next, I will explain the reasons why we issued these new regulations. Finally, my testimony will address the principal arguments that have been advanced by those who question these new rules.

II. The OCC's Regulations

In January of this year, the OCC issued two final rules that address the applicability of State law to national banks. The first regulation, which follows the approach taken by the Office of Thrift Supervision (OTS) in its preemption regulations for Federal savings associations, clarifies the extent to which the operations of national banks are subject to certain State laws by codifying the principles announced in a number of judicial decisions and OCC interpretations, as well as in OTS regulations (the preemption rule). The second rule amended aspects of the OCC's existing regulation concerning the OCC's exclusive "visitorial powers" with respect to national banks (the visitorial powers rule).

Increasingly in recent years, States – and even cities and counties – have enacted laws that attempt to constrain powers national banks are authorized to exercise under Federal law. In addition to conflicting with Federal authorities, these efforts have resulted in greater uncertainty about the standards applicable to national banks' operations, costly litigation to resolve that uncertainty, and in some respects, constriction of the availability of legitimate credit. One purpose of our regulations is to provide the clear guidance needed to ensure that national banks operate under uniform, predictable Federal standards. A second – and equally important – goal was to ensure that the Federal standards under which national banks operate directly address and prevent abusive or predatory lending practices. I next describe each rule in turn.

The Preemption Rule

The preemption rule adds provisions to our regulations expressly addressing the applicability of certain types of State laws to national banks' lending and deposit-taking activities. With regard to these activities, the preemption rule states the general principle that, except where made applicable by Federal law, State laws do not apply to national banks if they "obstruct, impair, or condition" the bank's exercise of powers granted under Federal law. The rules' preamble makes very clear that these words are not designed to create a new standard of preemption, but rather to distill the various phrases the Supreme Court has used in its preemption decisions.[1] In the lending and deposit-taking areas, the preemption rule then lists certain types of State laws that are preempted by Federal law and therefore are not applicable to national banks. In other words, the rule preempts the types of laws listed in the rule; other types of laws remain subject to case-by-case evaluation under established judicial standards.

For lending, examples of preempted laws include laws that restrict or prescribe the terms of credit, amortization schedules, permissible security property, escrow accounts, disclosure and advertising, and laws that require a State license as a condition of national banks' ability to make loans. For deposit-taking (in addition to laws dealing with disclosure requirements and licensing and registration requirements), the laws listed include laws that address abandoned and dormant accounts, checking accounts, and funds availability. In both areas, the listed types of laws either are preempted under longstanding, pre-existing OCC regulations, have been addressed in OCC preemption opinions, have been found to be preempted by the courts, or have been determined to be preempted by the OTS with respect to Federal thrifts. Thus, they are the types of laws for which substantial precedent exists recognizing the interference they pose to the ability of Federally chartered institutions to operate under uniform Federal standards.

The preemption rule also contains two new provisions that expressly prohibit abusive or predatory lending practices. First, the rule prohibits national banks from making any consumer loan based predominantly on the foreclosure or liquidation value of a borrower's collateral, rather than on the borrower's ability to repay the loan according to its terms. This anti-predatory lending standard applies uniformly to all consumer lending activities of national banks,

[1] 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004).

regardless of the location from which the bank conducts those activities or where its customers live. This standard strikes at the heart of predatory lending, namely lending practices that effectively swindle a homeowner out of his or her property.

Second, the preemption rule provides that, in connection with *any* type of lending, national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act (FTC Act), which prohibits "unfair or deceptive acts or practices" in interstate commerce. We added an express reference to Section 5 to our rule in response to commenters who urged us to affirm that this Federal standard applies to national banks. We viewed this addition as particularly appropriate in light of the fact that the OCC pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct.

It is important to emphasize that these new standards are comprehensive and they apply nationwide, to all national banks. The rules apply strong protections for national bank customers in every State – including the majority of States that do not have their own anti-predatory lending standards.

It also is important to emphasize several things that the preemption rule does *not* do. The final rule *does not* immunize national banks from all State laws, and it does *not preempt* undiscriminating laws of general applicability that form the legal infrastructure for conducting a banking or other business. Examples of laws that are not preempted are also identified in the preemption rule and include State laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts. The rule also does not disturb the status quo concerning preemption of State escheat and unclaimed property laws; rather, it reaffirms that preemption does not occur for those types of laws that the Supreme Court has found not to be preempted.[2]In addition, any other law that only incidentally affects national banks' exercise of their Federally authorized powers to lend, take deposits, and engage in other Federally authorized activities would not be preempted under the final rule. This distinction is solidly founded in decisions of the U.S. Supreme Court.

The rule *does not preempt anti-discrimination laws*. There appears to have been some misunderstanding on this point, perhaps because some State predatory lending laws that actually seek to regulate loan terms have "fair lending" in their titles.[3] The preemption rule, consistent with Federal judicial precedents,[4] does not preempt laws prohibiting discrimination in lending.

The rule *has absolutely no effect on real estate brokerage.* The rule neither enhances the ability of national banks to engage in real estate brokerage nor preempts State laws pertaining to real estate brokerage. National banks and their operating subsidiaries are not authorized to engage in the real estate brokerage business. The rule addresses certain types of State laws concerning real estate *lending*, not brokerage. Suggestions that the rule affects real estate brokerage activities are based on speculation about a combination of circumstances neither of which exists: (1)

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[2] *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944).

[3] *See, e.g.,* the Georgia Fair Lending Act, GA Code. Ann. §§ 7-6A-1 *et seq*., which does not address lending discrimination.

[4] *See, e.g., National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980) (New Jersey anti-redlining statute applicable to national banks); *see also Peatros v. Bank of America NT&SA et al*., 22 Cal 4th 147 (2000) (where Federal law otherwise provides in employment discrimination context, State anti-discrimination statute not necessarily preempted).

authorization of national banks and their operating subsidiaries to conduct real estate brokerage (they are not so authorized); and (2) an OCC rule preempting State real estate broker laws (there is no such rule).[5]

In fact, the preemption rule *does not authorize any new national bank activities or powers.* The rule does not address or affect activities authorized for financial subsidiaries. Nor does it impinge on the functional regulation framework for insurance and securities regulation established by Congress in the Gramm-Leach-Bliley Act.

Finally, the preemption rule makes no changes to the OCC's rules governing the activities of operating subsidiaries. The OCC already has rules on the books imposing the same terms and conditions on national banks' activities whether they are conducted directly or through an operating subsidiary, except where Federal law or regulation otherwise provide. By virtue of these pre-existing regulations,[6] the preemption rule has the same effect on national bank operating subsidiaries as it has on national banks.

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[5] Concerns about preemption of State real estate brokerage laws appear to be prompted not by the regulation the OCC has issued, but by the possibility that national banks could, in the future, be permitted to engage in real estate brokerage activities. Several years ago, the Board of Governors of the Federal Reserve System (Board) and the Department of the Treasury (Treasury) issued a proposal addressing whether real estate brokerage should be considered an activity that is "financial in nature," and thus permissible for financial holding companies and bank *financial subsidiaries*. *See* 66 Fed. Reg. 307 (January 3, 2001). The OCC's preemption rule would not apply to real estate brokerage activities even if the joint proposal were ever to be finalized. The rule does not apply to national bank financial subsidiaries. Thus its provisions do not preempt *any* State laws – including State real estate brokerage laws – for financial subsidiaries. Moreover, the preemption rule could not apply even if the Board-Treasury proposal were finalized because the applicability of State law to financial subsidiaries is determined under a different standard, that is, the standard that Congress expressly established in Section 104 of the Gramm-Leach-Bliley Act. 12 U.S.C. § 6701(d)(1).

[6] *See* 12 C.F.R. §§ 5.34 (operating subsidiaries subject to same "terms and conditions" as apply to the parent bank) and 7.4006 (applicability of State law to national banks). *See also id*. at § 34.1(b) (real estate lending rule applies to national bank operating subsidiaries).

The Visitorial Powers Rule

"Visitorial powers" is a term used to refer 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. Specifically, 12 U.S.C. § 484 provides that "no national bank shall be subject to any visitorial powers except as authorized by federal law, vested in the courts of justice" or exercised by Congress or a committee of Congress.[7] This provision dates from the earliest days of the national banking system and is integral to the overall scheme of the national banking system and the ability of national banks to conduct the business of banking subject to uniform, consistent standards and supervision, wherever in the nation they operate.

Existing OCC regulations implement the visitorial powers statute by providing that State officials are not authorized to inspect, examine, or regulate national banks, except where another Federal law authorizes them to do so.[8] The amendment to the visitorial powers 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.[9] In other words, the OCC is the exclusive supervisor of a national bank's banking activities. The rule *does not prevent* State officials from

[7] 12 U.S.C. § 484.

[8] 12 C.F.R. § 7.4000.

[9] 69 Fed. Reg. 1895 (Jan. 13, 2004).

enforcing State laws that do not pertain to a national bank's banking activities, such as health and safety standards or criminal laws of general applicability. [10]

Another amendment to the existing rule also clarifies that the *preservation* of visitorial powers "vested in the courts of justice" does not *grant* State officials new authority, in addition to whatever they may otherwise have, to use the court system to exercise visitorial powers over national banks. State Attorneys General do not dispute that Federal law prevents them from examining or taking actions directly against national banks, such as through cease and desist proceedings. What our revised rule says is that they may not use the courts to accomplish indirectly what they acknowledge the Federal statute prohibits them from accomplishing directly.[11] The visitorial powers rule *does not* preclude States from seeking a declaratory judgment from a court as to whether a particular State law applies to the Federally authorized business of a national bank.

Finally, like the preemption rule, the amendments to the visitorial powers rule make no change to the treatment of operating subsidiaries. Thus, in accordance with previously adopted OCC regulations, States generally can exercise visitorial powers over operating subsidiaries only to the extent that they could exercise visitorial powers over a national bank.

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[10] Moreover, the rule is fully consistent with the Riegle-Neal Act, which 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."* 12 U.S.C. § 36(f)(1)(B). Thus, when State law is applicable to interstate branches of national banks, the OCC is required to enforce such laws.

[11] *See* Footnote 28 in Brief of Amici Curiae of 41 State Attorneys General in Support of Defendant, in *Wachovia Bank, N.A. v. Watters*, Civil Action No. 5:03CV0105, U.S. District Court for the Western District of Michigan, January 29, 2004.

Some of the comments we received during the rulemaking process and some reactions to the final rules characterize them as "radical" or "dramatic" departures from the *status quo*. That characterization is simply incorrect.

The standard used in the preemption rule encapsulates the standards that the United States Supreme Court has applied in preemption cases for well over 130 years. It is phrased in words – "obstruct, impair, or condition" – that are taken from those cases. We have emphasized that we are not creating a new test for the threshold of preemption. The types of State laws identified as preempted in the rule include types of laws that a Federal court has previously held, or that the OCC has previously opined, are preempted, or that are already preempted under existing OCC regulations. The other types of laws listed as preempted are virtually the same as those listed in OTS regulations that have been on the books since 1996. The clarifications we have added to our existing visitorial powers rule reinforce the point that the statutory prohibition on the exercise of visitorial powers by authorities other than the OCC means what the text clearly says. No one other than the OCC is empowered to regulate or supervise the banking business of national banks unless Federal law provides that authority, and the statutory prohibition cannot be defeated by resort to the courts to impose regulatory standards or sanctions that the statute forbids State authorities from imposing directly.

What, then, has changed? What is different is that the legal conclusions that we have reached – and that have been reached in the context of comparable Federally chartered institutions – in preexisting rules, in legal opinions, orders, and sometimes briefs in litigation, are now collected together in one place and codified in rules. Now, all national banks can look to one source to identify specific and predictable standards to define their compliance responsibilities with regard to specified types of State laws. This is critically important if national banks are to be able to operate efficiently and exercise fully the powers that Federal law gives them.

III. The OCC's Commitment to Consumer Protection

The OCC's preemption rule both contains an anti-predatory lending standard and reaffirms the applicability to national banks of the prohibition on unfair and deceptive practices that is contained in the FTC Act. The addition of these provisions to our lending rules reinforces the obligations of national banks and their operating subsidiaries to treat their customers fairly and operate pursuant to high standards of integrity. Moreover, it is a consistent outgrowth of a series of actions we have taken to deter abusive lending practices and insure fair treatment of national bank customers.

It bears repeating that there is scant evidence that national banks and their operating subsidiaries are engaged in predatory practices. This conclusion is borne out not only by our own supervisory experience, but also by an extensive study of predatory lending conducted by the Department of Housing and Urban Development (HUD) and the Treasury Department.[12]

[12] 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.

Moreover, in a brief submitted in support of an OTS rulemaking concerning preemption of State lending standards, 46 State Attorneys General said that:

> 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.* * * * .
>
> Recent major state Attorneys General and Federal Trade Commission enforcement actions and settlements targeting predatory lending activities have all involved state housing creditors – namely, non-bank finance companies – and not supervised depository institutions * * *
>
> The Attorneys General are not aware of any similar actions relating to predatory mortgage lending directed against federal thrifts or national banks.[13]

All 50 State Attorneys General reiterated this point in their comment letter to the OCC on the proposal that preceded our final preemption rule, saying:

> 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*).[14]

It is important, in our view, that the Attorneys General, who have been clear about their disagreement with our preemption rule, have not found national banks and their operating subsidiaries to be engaged in predatory lending to any discernable degree. I mention the point here, by way of preface, in order to emphasize that the approach the OCC has taken to combating

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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.

[13] 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, 12 (emphasis added).

predatory and abusive lending practices is tailored, appropriately, to the extent that the issue exists in the national banking system.

The OCC's Anti-Predatory Lending Standards

The OCC is the first, and thus far the only, Federal banking agency to issue anti-predatory lending guidance. Two advisory letters issued a year ago provide comprehensive supervisory guidance directed at ensuring that national banks and their operating subsidiaries do not become involved in abusive or predatory mortgage lending practices.[15]

The OCC's supervisory guidance details steps for national banks to take to ensure that they do not engage in such practices. The guidance makes clear that national banks should adopt policies and procedures to prevent predatory lending practices in direct lending *and* in transactions involving brokers and purchased loans. Each of the Advisory Letters expressly covers national banks as well as their operating subsidiaries.

Significantly, AL 2003-2 provides that bank policies and procedures on direct lending should reflect the degree of care that is appropriate to the risk of a particular transaction. In some cases, this will entail making the determination that a loan is reasonably likely to meet the borrower's individual financial circumstances and needs. We also emphasize that if the OCC has evidence that a national bank or its operating subsidiary has engaged in abusive lending practices, we will review those practices, not only to determine whether they violate specific provisions of law

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[14] National Association of Attorneys General, Comment Letter Re: Docket No. 03-16 (dated Oct. 6, 2003) at 10 (emphasis added).

[15] *See* OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 18, 2003; OCC Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 18, 2003.

such as the Home Ownership and 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 standards – such as equity stripping, loan flipping, and the refinancing of special subsidized mortgage loans that originally contained terms favorable to the borrower – could well be found to be unfair practices that violate the FTC Act.

We issued our second advisory, AL 2003-3, to address concerns that have been raised about the all-too-common link between predatory lending and non-regulated lending intermediaries, and to address the risk that a national bank could indirectly facilitate predatory lending through the purchase of loans and mortgage-backed securities and in connection with broker transactions. Our guidance stresses that national banks need to perform adequate due diligence prior to entering into any relationships with loan brokers, third-party loan originators, and the issuers of mortgage-backed securities, to ensure that the bank does not do business with companies that fail to employ appropriate safeguards against predatory lending in connection with loans they arrange, sell, or pool for securitization. We also advise national banks to take specific steps to address the risk of fraud and deception in brokered loan transactions relating to broker-imposed fees and other broker compensation vehicles.

The OCC's Examination and Supervisory Processes

The OCC conducts comprehensive examinations of a national bank's business, including its adherence to safe and sound banking practices and its compliance with several dozen Federal consumer protection laws. Through a network of examiners located throughout the U.S., we monitor conditions and trends, both in individual banks and in the national banking system as a whole. Our supervisory activities focus on the risks as identified by our supervisory monitoring tools and subject matter experts. Federal law requires that the OCC examine national banks at least once every 12 or 18 months, depending on the size and condition of the bank.[16] However, the largest national banks have on-site examination teams conducting continuous examinations of all aspects of the bank's operations. In addition, the OCC may at any time conduct targeted safety and soundness and compliance examinations.

This system of supervision applies to national banks and their operating subsidiaries. The OCC supervises national banks by business line, not according to corporate form, so the standards applied in the course of that supervision are the same for national banks and their operating subsidiaries. The book figures of a parent national bank and its operating subsidiaries are combined for purposes of applying statutory or regulatory limits, such as lending limits or dividend restrictions. The OCC reviews the institution's policies and procedures in an effort to assess whether they adequately identify and address the risks the institution may face, given the nature and scope of its business. Finally, the OCC evaluates the adequacy of all elements of the institution's business, including capital, earnings, assets, management, liquidity, sensitivity to market risk, and information systems.

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[16] 12 U.S.C. § 1820(d)(1). The general rule requires examinations every 12 months. However, if a bank has less than $250 million in assets and is in good condition, the OCC need only examine it at least once every 18 months. *Id.* § 1820(d)(4).

Through our safety and soundness and compliance examinations, the OCC reviews the adequacy of the bank's policies, systems and controls, relative to the character and complexity of the bank's business and assesses whether the bank's activities are being carried out in compliance with applicable laws and regulations. As part of these reviews, examiners typically sample transactions to assess the adequacy of the bank's systems and controls. For example, as part of an asset quality review, the sample of loans will be reviewed to determine the quality of the loans, the adequacy and completeness of the information concerning the loan and the borrower, and whether the lending function is being carried out in compliance with applicable laws.

Depending on the bank's risk profile and other supervisory information, examiners may target their reviews to a particular loan product, business line, or operating unit. For example, if the bank is engaging in significant new or expanded mortgage lending activities through an operating subsidiary, examiners normally would select a sample of those loans for review. Similarly, as part of our compliance reviews, examiners may select a sample of consumer loan or deposit products to verify that the bank's systems and controls are adequate and that the bank is complying with applicable consumer protection laws and regulations. If the sampling process indicates potential issues, we will expand our reviews as appropriate. The examination process is intended to provide a high level of assurance that each aspect of an institution's business is conducted in compliance with applicable laws and on a safe and sound basis. Through this process, we are able to examine national banks and their operating subsidiaries for potentially abusive lending practices as well as compliance with the host of specific Federal consumer protection requirements to which they are subject.[17] Our compliance supervision is an integral part of our comprehensive, ongoing oversight of the national banking system.

Today, the OCC supervises approximately 2100 national banks, together with their operating subsidiaries. Compliance and enforcement at the OCC are carried out through our corps of bank examiners and attorneys. We have nearly 1700 examiners in the field, hundreds of whom are involved in both safety and soundness and compliance supervision. Over 100 examiners throughout the country work exclusively on compliance supervision. We have over 300 examiners on site at our largest national banks, engaged in continuous supervision of all aspects of their operations. These resources are supplemented by dozens of attorneys in our district offices and Washington D.C. who work on compliance matters.

The 40 employees in our Customer Assistance Group (CAG) located in Houston, Texas, further supplement these functions. The CAG provides direct assistance to customers of national banks and their subsidiaries to resolve individual complaints. It also collates and disseminates complaint data that help point our examiners toward banks, activities, and products that require further investigation or transaction testing through product sampling. While the CAG is an important supplement to our compliance supervision functions, it is by no means all there is to it.

[17] Federal consumer protection laws and regulations that apply to national banks and to national bank operating subsidiaries include: the 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; the new OCC anti-predatory lending rules in 12 C.F.R. 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.pdf); and 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.pdf. and http://www.occ.treas.gov/ftp/advisory/2003-3.pdf).

By way of comparison, based on data published by the Conference of State Bank Supervisors, State banking departments collectively supervise approximately 113,000 entities, of which approximately 6,000 are commercial banks.[18] For all these entities, the States report that they have 2,308 examiners.[19] Thus, if one were to look only at commercial banks and assume all State examiners were dedicated to commercial bank supervision, OCC's resources exceed those of the States on a per-supervised bank basis. But, in fact, State banking departments are responsible for many entities in addition to commercial banks. These include, depending on the State, savings banks, thrifts, bank holding companies, mortgage bankers and brokers, industrial loan companies, non-bank trust companies, money transmitters, consumer finance companies, other licensed lenders, payday lenders, title lenders, check cashers, pawnshops, bankers' banks, securities brokers and dealers, and funeral parlors. Thus, on a per-supervised entity basis, the OCC has significantly more resources than do the States. This is exactly the opposite of what some critics of our regulations have suggested. These suggestions – that our resources are inadequate to enable the OCC to supervise compliance effectively or to fulfill the consumer protection aspect of our mission – are without foundation.

Moreover, we continue to act on our strong commitment to preventing abusive or predatory lending practices in the national banking system and ensuring that the institutions we supervise adhere to high standards of customer service, integrity. Recently, for example, the OCC issued a new advisory letter to national banks clarifying our expectations about how they should handle

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[18] *A Profile of State Chartered Banking*, Nineteenth Edition, 2002-2003, Conference of State Bank Supervisors.

[19] *Id*. See attached chart.

customer complaints that are forwarded to them from State agencies and departments.[20] We took that opportunity to emphasize the importance of resolving consumer complaints fairly and expeditiously, regardless of the source of the complaint, and to remind banks that their complaint resolution processes are subject to review as part of our regular supervision of their compliance management programs.

If, as a result of our examination or supervisory processes, or upon investigation of referrals or complaints, we find abusive practices in a particular institution, we take action to stop them. As I next describe, the OCC has a wide array of effective enforcement tools that we can use to do so.

The OCC's Enforcement Program

Section 8 of the Federal Deposit Insurance Act gives the OCC broad powers to compel compliance with any "law, rule, or regulation." This includes the ability to issue cease and desist orders when the OCC determines that a national bank or its operating subsidiary has violated any applicable Federal law or regulation or any applicable State law or regulation.[21] In an appropriate case, the cease and desist order may include restitution or a requirement for such other affirmative action as the OCC determines is appropriate.[22] Our record shows that we have

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[20] OCC Advisory Letter 2004-2, "Consumer Complaints Referred to National Banks from State Officials," February 26, 2004.

[21] 12 U.S.C. § 1818(b)(1). *See National State Bank of Elizabeth, N.J. v. Long*, 630 F.2d 981, 988-89 (3d Cir. 1980) (confirming the OCC's authority under 12 U.S.C. § 484 to enforce an applicable State redlining statute).

[22] 12 U.S.C. § 1818(b)(6).

been willing and able to use these remedies to protect customers and to address unfair, deceptive, or abusive practices when such situations occur.

- The OCC was the first Federal banking agency to take enforcement action against an institution it supervises for violations of Section 5 of the FTC Act. In a groundbreaking case, the OCC asserted section 5 of the FTC Act as a basis for seeking a cease and desist order, as well as affirmative remedies, against Providian National Bank.[23] The bank's settlement of that matter with the OCC required that it pay over $300 million in restitution to customers who had been the victims of unscrupulous marketing practices in connection with its "credit protection" program. Restitution through this single action was available to thousands of the bank's customers, nationwide.

- We have continued to bring actions based on violations of section 5 of the FTC Act where practices warrant. We have obtained millions of dollars in restitution for national bank customers in cases including:

  - In the Matter of Clear Lake National Bank, San Antonio, Texas, Enforcement Action 2003-135 (required restitution of fees, finance charges, and interest re so-called "tax lien loans").

[23] In the Matter of Providian National Bank, Tilton, New Hampshire (June 28, 2000). *See also* Agreement By and Between First National Bank, Ft. Pierre, South Dakota and the OCC (July 18, 2002) (formal agreement requiring national bank to cease violations of section 5 of the FTC Act in connection with the solicitation of credit cards).

- 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), National Association, Las Vegas, NV, Enforcement Action 2003-17 (required restitution re private label credit cards).[24]

- In the Matter of First National Bank in Brookings, Brookings, South Dakota, Enforcement Action 2003-1 (restitution re: credit cards).

- In the Matter of First National Bank of Marin, Las Vegas NV, Enforcement Action 2001-97 (restitution re: credit cards).

- In the Matter of Direct Merchants National Bank, Scottsdale, AZ, Enforcement Action 2001-24 (restitution re: credit cards).

- We have moved aggressively against national banks engaged in payday lending programs that involved consumer abuses as well as practices inconsistent with safety and soundness. Specifically, we concluded the following four enforcement actions against national banks that had entered into contracts with payday lenders for loan originations, in each case ordering the bank to terminate the relationship with the payday lender:

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[24] In an action brought by the State of Arizona against this bank, among others, a State court recently observed that the restitution and remedial action that had been ordered by the OCC against the bank was "comprehensive and significantly broader in scope that that available through [the] State court proceedings." *State of Arizona v. Hispanic*

- In the Matter of Peoples National Bank, Paris, Texas, Enforcement Action 2003-2. We also assessed civil money penalties against Peoples National Bank in this matter for violating Federal consumer protection statutes.

- In the Matter of First National Bank in Brookings, Brookings, South Dakota, Enforcement Action 2003-1 (as noted previously, we also ordered restitution in this action).

- In the Matter of Goleta National Bank, Goleta, California, Enforcement Action 2002-93. We also assessed civil money penalties against Goleta National Bank in this matter for violating Federal consumer protection statutes.

- In the Matter of Eagle National Bank, Upper Darby, Pennsylvania, Enforcement Action 2001-104.

The OCC is authorized to take the same enforcement actions and order the same remedies against national bank operating subsidiaries as we can against national banks.

The following are examples of enforcement actions we have taken where the basis for the action or the remedy ordered, or both, involved a national bank operating subsidiary:

Air Conditioning and Heating, Inc., CV 2000-003625, Ruling at 27 (Aug. 25, 2003) (Superior Court of Arizona, Maricopa County).

- NationsBank, N.A., Charlotte, NC (now known as Bank of America, N.A.)

  The OCC assessed a $750,000 civil money penalty against NationsBank for unsafe or unsound practices at NationsSecurities, Inc., an operating subsidiary, relating to the sale of non-deposit products to customers. The OCC determined that NationsSecurities violated a condition of the OCC's approval of NationsBank's operating subsidiary notice. The condition related to providing appropriate disclosure to customers concerning the uninsured nature of the non-deposit products being sold and the relationship of the involved entities to the products.

- Advanta National Bank, Philadelphia, PA

  The OCC issued a Consent Cease and Desist Action and two Formal Agreements to address numerous violations of law and unsafe and unsound banking practices conducted through the bank's mortgage lending subsidiary, and to require the disposition of the bank's mortgage lending operation.

- Household Bank (SB), N.A., Las Vegas, NV

  The OCC issued a Formal Agreement against the bank requiring restitution to be paid to customers for unsafe or unsound practices and violations of consumer laws by the bank's retail services operating subsidiary in connection with solicitation and remediation of customers' complaints concerning the bank's credit cards.

- First Consumers National Bank, Beaverton, Oregon

  The OCC issued a Consent Order in May 2002 against the bank requiring it to review all transactions with its affiliates and subsidiaries and to obtain any restitution owed to the bank from such entities, including a securitization operating subsidiary, resulting from violations of affiliate transaction laws and unsafe/unsound contracts. The OCC also required the bank (and, consequently, its subsidiary) to liquidate.

The national banking system today is safe and sound, and the operations of national banks reflect high standards. We are committed to assuring that this is always the case. In those exceptional cases where those standards are not met, we have the legal authority, the resources, and the commitment necessary to pursue appropriate sanctions and remedies.

Finally, as I noted early on in this statement, the preemption regulation that we adopted is 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 State officials indicated – that OTS preemption regulations have undermined the protection of customers of Federal thrifts.   There is no reason to expect that the results will be different for the customers of national banks.

IV. The OCC's Reasons for Adopting the Regulations

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 by Congress to operate, throughout the nation, under uniform, Federally-set standards of banking operations. As a result, there is an extensive body of Federal court precedents that reiterate and apply preemption principles to a variety of different types of State laws.[25] Yet, banks increasingly have been forced to litigate – sometimes repeatedly on the same issue – to clarify the applicability of specific types of State laws, and the OCC has issued separate legal opinions that address the applicability of State law. As national banks operate in an increasingly complex and multi-state environment, the shortcomings of this expensive and time-consuming case-by-case approach have become increasingly apparent. In addition, the financial and opportunity costs to banks of a case-by-case approach may be significant – especially where litigation becomes necessary to establish clear standards.

Rather than continuing to address preemption issues on a piecemeal basis, the preemption rules address them collectively – by clarifying and codifying prior judicial and OCC interpretations based on long-established Constitutional principles – to provide clear ground rules for national banks concerning the applicability of specified types of State laws.

[25] *See, e.g., Bank of America v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 123 S. Ct. 2220, 2003 U.S. LEXIS 4253 (May 27, 2003) (the National Bank Act and OCC regulations together preempt conflicting State limitations on the authority of national banks to collect fees for the provision of electronic services through ATMs; municipal ordinances prohibiting such fees are invalid under the Supremacy Clause); *Wells Fargo Bank, Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003) (Texas statute prohibiting certain check cashing fees is preempted by the National Bank Act); *Metrobank v. Foster*, 193 F. Supp. 2d 1156 (S.D. Iowa 2002) (national bank authority to charge fees for ATM use preempted Iowa prohibition on such fees). *See also Bank One, Utah v.*

The changing financial services marketplace

As explained in the preamble to the preemption rule, markets for credit, deposits, and many other financial products and services are now national, if not international, in scope, as a result of significant changes in the financial services marketplace, particularly in the last 20 years. Now, more than ever before, the imposition of an overlay of 50 State and an indeterminate number of local standards and requirements on top of the Federal requirements and OCC supervisory standards to which national banks already are subject has costly consequences that can materially affect a national bank's ability to serve its customers.

The changes we see in the market for financial services 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, with customers located throughout the nation obtaining mortgages based on sophisticated credit-scoring derived from centralized credit underwriting facilities. 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, from providers whose location may well be irrelevant. With respect to deposits, consumers can compare rates and

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Guttau, 190 F.3d 844 (8th Cir. 1999), *cert. denied sub nom Foster v. Bank One, Utah*, 529 U.S. 1087 (2000) (holding that Federal law preempted Iowa restrictions on ATM operation, location, and advertising).

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, reach customers across State lines and 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.[26] 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 customer. They also accentuate the costs and interference that diverse and

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

potentially conflicting State and local laws have on the ability of national banks to operate under the powers granted by their Federal charter.

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, and their customers may face higher costs or more limited product offerings – or both – as a result. 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 financial exposure. In some cases, this deters them from making certain products available in certain jurisdictions. As was recently observed by Federal Reserve Board Chairman Alan Greenspan, "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."[27]

It has been suggested that the ability to do business in multiple States, under uniform, consistent and predictable standards, primarily benefits the largest banks. In fact, for community and intermediate-sized banks with customers in multiple jurisdictions, this attribute of the national bank charter may have even more practical significance than for a "megabank." Take, for example, a community bank with customers in a multi-state metropolitan area like New York or Philadelphia or Washington, D.C.; or a community bank with customers in a compact multi-state

[27] Letter of February 28, 2003, from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to The Honorable Ruben Hinojosa (cited by Congressman Hinojosa on November 21, 2003, during House debate on the Conference Report to accompany H.R. 2622 (Conference Report 108-396)).

region, such as New England; or any State-based bank in a State in which cities or municipalities enact unique local requirements for bank operations. Community and intermediate-sized regional banks have a smaller base of operations, *e.g.*, a smaller number of loans, over which they are able to spread the overhead costs of legal staff, compliance staff, technology, and printing costs necessary to comply with multiple State (and potentially local) requirements. This drives up their costs, and detracts from their ability to compete effectively with larger banks that have a bigger base of operations over which to apply overhead costs. This, in turn, serves as a disincentive for those banks to incur still more costs by expanding service to customers in a new State. Ultimately, the inability to compete on a cost-effective basis can be a factor that contributes to management decisions to merge or be acquired by a larger institution.

As we have learned from our experience supervising national banks, from the inquiries we have received, by the extent of litigation in recent years over these State efforts, and by the comments we received during our rulemakings, national banks' ability to conduct operations to the full extent authorized by Federal law has been impaired as a result of increasing efforts by States and localities to apply State and local laws to national banks. For example, commenters on our proposal to adopt the preemption rule 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, increased risks, and operational impediments.[28] Other commenters noted the proliferation of State and local predatory lending laws and the impact that

[28] 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 6 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.

those laws are having on lending in the affected jurisdictions. As a result, national banks must absorb the costs, pass the costs on to consumers, or simply curtail lending in jurisdictions where the costs are prohibitive or risks are imprudent. Commenters noted that this result occurs 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.

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. For example, the impact of particular State laws on the mortgage market and credit availability is discussed in detail, below.

Access to the secondary mortgage markets

The continuing uncertainty about the applicability of State laws has already affected national banks' ability to lend in certain markets and to access the secondary market, a curtailment of their business that is inconsistent with their Federally authorized powers and that has the potential to adversely affect credit availability as well as detract from the banks' financial position.

The trend at the State and local levels toward enacting legislation that seeks to impose costly and inconsistent compliance burdens on national banks has accelerated in recent years. These laws are well-intentioned but nonetheless curtail national banks' ability to conduct operations to the full extent authorized by Federal law and can disrupt credit delivery systems.

For example, in recent years, various States and localities have enacted predatory lending laws, each employing a combination of standards that differs in some respects from the others, but each typically singling out loan product features and either barring loans with those features or imposing requirements that make it very costly for lenders to offer them. The goals of these laws – to eliminate predatory and abusive mortgage lending practices – are laudable and we strongly support their objectives. As I have repeatedly said, predatory and abusive practices have no place in the national banking system, and, as I have shown, we will take vigorous action to assure that this is the case.

However, these State and local law approaches can have the effect of banning subprime loans based on certain loan terms. They generally prohibit certain mortgage loan terms and impose extra compliance obligations when certain other loan terms or conditions are present. They introduce new standards for subprime lending that are untested, sometimes vague, often complex, and different from established Federal requirements. They also create new potential liabilities and penalties for any lender who missteps in its efforts to comply with those new standards and restrictions. These laws materially increase a bank's costs and compliance and reputation risks, especially in connection with risk-based pricing to the subprime market.

It is important to understand that this approach, while intended to stop abusive practices, also can work to constrain legitimate risk-priced lending to credit-worthy subprime borrowers.[29] Like any State regulator, the OCC is dedicated to ensuring that the institutions we supervise are not engaged in abusive or predatory lending practices. However, our approach is to focus on preventing those *practices,* not on banning or restricting specified loan products or terms in the absence of evidence of abusive, predatory, unfair, or deceptive practices.

Often, State and local predatory lending laws that have such a *product*- rather than *practice*-focus have created uncertainties that adversely affect banks' ability to access the secondary market for legitimate, risk-priced mortgage loans. When a bank is able to sell a loan on a cost-effective basis to Fannie Mae or Freddie Mac, or obtains a rating for a pool of loans that it "securitizes" and sells to investors, the bank is able to liquify its loans and redeploy capital to make additional loans available. If Fannie or Freddie are unwilling to purchase loans made in jurisdictions with specialized predatory lending restrictions and potential liabilities, the funds banks have available to make additional credit available are diminished. Similarly, if a bank is unable to obtain a rating from Standard and Poors' (S&P), Moody's Investors Services, or Fitch Ratings, it will not be able to securitize its loans on a cost-effective basis and redeploy capital to make additional credit available. In other words, localized and State-based restrictions on loan terms substantially affect the marketability of such loans, and that, in turn, affects overall credit availability.

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[29] It is important to note that many legitimate, risk-priced mortgage loans would be considered "high cost home loans" under some State anti-predatory lending laws. For example, a "high cost" home loan under Georgia's anti-predatory lending law includes mortgages that have total points and fees exceeding 5% of the loan amount if the mortgage is $20,000 or more. On a $30,000 mortgage, this would mean any loan with origination fees of more than $1,500 would be considered "high cost." According to the Mortgage Bankers Association's 2002 Cost Study, the average cost to originate a mortgage in 2001 was $1,744.

Fannie Mae and Freddie Mac have both issued policies concerning their willingness to purchase residential mortgage loans subject to various State predatory lending laws. Fannie Mae and Freddie Mac will not purchase high cost home loans from **Arkansas, Georgia, Kentucky, Illinois, Maine, Nevada, New Jersey, New Mexico, New York, and Oklahoma**.

S&P, Moody's, and Fitch have also issued policies concerning the inclusion of high cost loans from jurisdictions with predatory lending laws in structured finance transactions.[30] Under these policies, the rating agencies generally will not rate residential mortgage-backed securities (RMBS) structured finance transactions containing loans that carry unquantifiable assignee liability. Therefore, high-cost loans originated in States with anti-predatory lending laws providing for uncapped or unascertainable assignee liability must generally be excluded from a securitization in order for the transaction to be rated. [31]

S&P and Fitch will rate securitizations containing loans originated in States with anti-predatory lending laws that provide for limited, or quantifiable, assignee liability, but only subject to additional credit enhancements and additional representations and warranties. Lenders doing business in the States discussed below face the following additional secondary market constraints:

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[30] *See* Standard & Poor's: "Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach" (April 15, 2003); Moody's Investor Services: "Impact of Predatory Lending Laws on RMBS Securitizations" (May 6, 2003); and Fitch Press Release: **"**Fitch Revises its Rating Criteria in the Wake of Predatory Lending Legislation" (May 1, 2003).

[31] *See, e.g.,* "Standard & Poor's Permits Additional New Jersey Mortgage Loans Into Rated SF Transactions" (Nov. 25, 2003) ("Standard & Poor's will continue to exclude High-Cost Home Loans because of the potential for uncapped statutory and punitive damages."); and Mortgage Bankers Association Industry News: **"**Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004)("Since a lender or assignee of any 'high-cost home loan' may be subject to unlimited liability under the Act, Fitch will not rate RMBS transactions containing high-cost home loans originated in New Mexico as of Jan.1, 2004.") .

- **Arkansas, Georgia, Illinois, Maine, Nevada, New York, Oklahoma**, **North Carolina and South Carolina.** In these States, S&P generally requires that sellers provide representations and warranties that the loans were originated in compliance with all applicable laws and that their compliance procedures effectively identify high cost home loans and determine that the loans do not violate predatory lending laws. Further, S&P requires that the provider of these representations and warranties be sufficiently creditworthy to purchase any loans that are in violation and cover any contingent liability associated with securitizing high cost home loans.[32] Fitch will generally rate securitizations with loans from these jurisdictions (except North Carolina and South Carolina), but it will require additional representations and warranties and may require additional credit enhancements.[33] Fitch has not yet issued a statement with regard to loans originated in North Carolina or South Carolina.
- **Kentucky**. S&P requires sellers to conduct a loan-by-loan review of all high-cost home loans, and provide the representations and warranties noted above before it will allow

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[32] *See* “S&P Addresses Arkansas Home Loan Protection Law” (July 11, 2003); Standard & Poor’s: “Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach” (April 15, 2003) (Georgia and New York); “S&P Addresses Illinois High Risk Home Loans Act” (Nov. 17, 2003); “S&P Addresses Amendment to Maine Truth in Lending Act” (Sept. 12, 2003); “S&P Addresses Nevada Anti-Predatory Lending Law”; “S&P Addresses Oklahoma Anti-Predatory Lending Law” (Nov. 18, 2003); and "S&P Addresses North Carolina Anti-Predatory Lending Law" (Feb. 12, 2004).

[33] *See* “Fitch Ratings Responds to Arkansas Predatory Lending Legislation” (June 20, 2003); Mortgage Bankers Association Industry News: “Fitch to Rate RMBS After Amendment to Georgia Predatory Lending Statute, GFLA” (Mar. 14, 2003); Mortgage Bankers Association Industry News: “Fitch Ratings Addresses Illinois Predatory Lending Legislation” (Dec. 15, 2003); “Fitch Ratings Responds to Maine Predatory Lending Legislation” (Sept. 29, 2003); “Fitch Ratings Responds to Nevada Predatory Lending Legislation” (Oct. 3, 2003); Mortgage Bankers Association Industry News: “Fitch: New York State Anti-Predatory Lending Legislation” (Mar. 26, 2003)***;*** and “Fitch Ratings Addresses Predatory Lending Legislation of Oklahoma” (Oct. 30, 2003).

high cost home loans from Kentucky in rated transactions. [34] Fitch will not allow any high cost loans from Kentucky in rated transactions. In order to rate a transaction including *any* loans from Kentucky, Fitch requires receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from Kentucky and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in Kentucky. [35]

- **New Jersey**. S&P and Fitch will not rate securitizations with certain high cost home loans from New Jersey.[36] In order to rate a transaction including *any* loans from New Jersey, Fitch requires, as it does in Kentucky, receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from New Jersey and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in New Jersey.[37]
- **New Mexico**. S&P will rate securitizations containing high cost home loans subject to the additional representations and warranties it requires in Arkansas, Georgia, Illinois,

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[34] *See* "S&P Addresses Kentucky High-Cost Law" (Jun. 20, 2003).

[35] *See* Mortgage Bankers Association Industry News: "Fitch Ratings Responds to Kentucky Predatory Lending Legislation" (Jun. 30, 2003); and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004).

[36] *See* "S&P Permits Additional New Jersey Mortgage Loans Into Related SF Transactions" (November 25, 2003).

[37] *See* "Fitch Ratings Responds to New Jersey Predatory Lending Legislation" (Jun 5, 2003)*;* and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004)**.**

> Maine, Nevada, New York, North Carolina, and Oklahoma.[38] Fitch, however, will not rate any transaction containing high cost home loans subject to New Mexico's anti-predatory lending law. Fitch notes that assignee liability may be unlimited in the case of punitive damages, which may be imposed for acts found to be reckless or malicious. Fitch further requires that the seller of any New Mexico loan provide adequate evidence that the transaction will enjoy the benefits of the new law's safe harbor from the law's unlimited liability for assignees and purchasers. In order to be protected by this safe harbor, a purchaser/securitizer must conduct due diligence and provide certain representations and warranties. Because it is unclear what constitutes sufficient "due diligence" under the New Mexico statute, Fitch requires the third party certificate and random sampling it requires in Kentucky and New Jersey.[39]

These constraints translate into cost burdens at each stage of the lending process. For example, a rating agency that is willing to rate a RMBS securitization containing high-cost loans at all may, as we have seen, require representations, warranties, sampling, and certifications that go beyond the industry standard. Satisfying these extra conditions may require a bank to increase its compliance staff, provide additional training to both existing and new staff, and pay fees to obtain third-party sampling and certification. If the rating agency requires additional credit enhancement, providing that will generally add to the financial cost of the transaction. Finally, if the bank cannot securitize the loans and must therefore retain them on book, the bank does not realize funds that it could use to make additional loans and the bank will incur carrying costs.

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[38] *See* "S&P Addresses New Mexico's Home Loan Protection Act" (Nov. 25, 2003).

[39] *See* Mortgage Bankers Association Industry News: **"**Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004).

These costs either will be passed back to the bank's customers or, if the bank concludes they are unacceptably high, will compel the bank to stop making loans covered by State anti-predatory lending laws.

The rating agencies have, however, responded favorably to preemption decisions by the Federal banking agencies. Shortly after Fitch announced that it would not rate residential mortgage backed securitizations containing high cost home loans originated in New Mexico, Fitch also announced that, beginning the day the OCC's preemption rule becomes effective (February 12, 2004), it *will* rate residential mortgage backed securitizations containing loans subject to any State or local anti-predatory lending laws that were originated by OCC-regulated national banks or their operating subsidiaries without additional credit enhancements.[40] This follows Fitch's August 22, 2003, decisions to rate securitizations without additional credit enhancement by OCC-regulated lenders in Georgia in light of the OCC's Preemption Order and Determination concerning the GFLA,[41] and by OTS-regulated lenders in all jurisdictions in light of the OTS's preemption regulations and various preemption opinions.[42]

On October 3, 2003, S&P made the same decision concerning the GFLA Determination and Order.[43] On March 3, 2004, S&P announced that it had completed its review of the real estate

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[40] *See* "Fitch Ratings Addresses Preemption Statement from the OCC" (Jan. 16, 2004).

[41] *See* 68 Fed. Reg. 46264 (Aug. 5, 2003).

[42] *See* "Fitch Ratings Addresses Preemption Statements from the OTS and OCC" (Aug. 22, 2003).

[43] *See* "S&P Announces Position on OCC's Preemption Order for the GFLA" (Oct. 3, 2003).

lending provisions in the OCC's preemption rule[44] and that, as a result, it will rate securitizations containing loans originated by national banks or their operating subsidiaries in Georgia, Illinois, Kentucky, Maine, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, and South Carolina. For loans originated in these jurisdictions, S&P will continue to rely on the seller's representation and warranty that the loans included in the pool were originated in compliance with all applicable laws, including anti-predatory lending laws. In addition, S&P will require legal comfort in the form of an officer's certificate indicating that the originator of the loan is a national bank or a national bank operating subsidiary.[45]

These decisions are critical because, without a certain secondary market for these loans, banks making risk-priced loans covered by this type of State law will be required to hold more of these loans to maturity. This, in turn, ties up more of a bank's capital as it carries the mortgage assets on its books, and adversely affects the ability of the bank to originate or acquire new loans.

As a result of these higher costs and operational challenges, lenders 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. It has been reported that three major lenders have announced they will no longer do business in New Jersey because of the State's

[44] On November 25, 2003, having reviewed the OTS's preemption opinions concerning the anti-predatory lending laws in Georgia, New Jersey, New Mexico, and New York, S&P announced that it would no longer apply its published criteria to Federal thrifts and their operating subsidiaries operating in those States. *See* "S&P Announces Position on OTS Preemption Pronouncements" (Nov. 25, 2003).

[45] See "S&P Addresses OCC Rule Regarding Preemption of State Anti-Predatory Lending Laws" (March 3, 2004). S&P said it was unable to conclude with certainty that assignees and purchasers of loans originated by national banks in Arkansas are not subject to liability. Therefore, S&P said, it will continue to apply its previously announced criteria with respect to such loans.

predatory lending law, and at least 18 have significantly limited their lending activities there.[46] As lenders react like this, legitimate credit availability is reduced and consumers will have fewer options for home loans.

V. Correcting Misperceptions about the Preemption and Visitorial Powers Rules

Some of the comments and reaction we have received in response to our rules seem to reflect fundamental misconceptions about the law on which the rules are based, or the effect of the regulations. I welcome the opportunity to address these misconceptions.

1. The OCC's rules do not leave consumers vulnerable to abusive lending practices.

It is simply not the case that national bank customers will become vulnerable to abusive lending practices as a result of our rules. First, national banks and their operating subsidiaries are not where predatory and abusive lending practices are festering. Second, national banks and their operating subsidiaries are governed by strong Federal standards designed to prevent these practices. Third, the OCC deploys substantial resources, nationwide, to ensure that these practices do not gain a foothold in the national banking system. Our examiners and supervisors have available a wide array of supervisory and enforcement tools to identify and remedy any such practices that do occur. Finally, the ability of State authorities to take aggressive action to protect vulnerable consumers from predatory practices by other types of institutions – the very

[46] *See* Paul Muolo and Brad Finkelstein, *Lenders Leaving New Jersey*, Dec. 2003, American Banker-Bond Buyer, Vol 13, No. 3 at 41.

institutions that have been identified as the source of abusive practices – is unaffected by our regulations.

Clearly, there is a real problem with abusive lending practices in this country, but national banks are not the breeding ground. Whatever differences of opinion may exist with the State Attorneys General, they have stated unambiguously in various filings, as I have described, that there is scant evidence that national banks, or their subsidiaries, are engaged in abusive lending practices. Indeed, these State officials have recognized the extent to which banks (and thrifts) are highly regulated and closely supervised, and have credited that regulatory presence for the scarcity of evidence of abusive or predatory practices.

National banks and national bank operating subsidiaries are subject to comprehensive, regular – in the case of large banks, continuous – supervision, and an extensive array of Federal consumer protection laws and regulations – including the anti-predatory lending standard in our new regulation and section 5 of the FTC Act – administered and enforced by the OCC.[47] As I have described, the OCC's consumer compliance program is fully and effectively staffed by examiners and compliance specialists whose work is supported by attorneys and consumer complaint specialists. OCC examinations of national banks and national bank operating subsidiaries are conducted to ensure and enforce compliance with Federal laws and regulations and with supplemental OCC supervisory standards. On those limited occasions where we have found national banks to be engaged in unacceptable practices, we have taken vigorous enforcement

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[47] *See supra* note 17.

action.[48] We will continue to use the supervisory measures and enforcement tools available to us to keep such practices out of the national banking system.

Neither the preemption rule nor the revised visitorial powers rule prevents State officials from applying and enforcing generally applicable State laws that do not attempt to control the content or conduct of national banks' banking activities. Our jurisdiction over national banks and their subsidiaries also does not deprive State regulators of a role in protecting consumers in their States, and we welcome the opportunity to work cooperatively with them to further that goal. We have invited State authorities to refer consumer complaints concerning national banks to the OCC, and to bring to our attention concerns that any national bank is engaged in unfair, deceptive, abusive or predatory practices. We have set up special procedures to handle and track referrals from State authorities.

The OCC and the States already cooperate extensively in many respects, referring consumer complaints to the appropriate regulator of the entity generating the complaint, and we welcome additional opportunities to collaborate.[49] Our new Advisory Letter clarifies how national banks should handle consumer complaints that are forwarded to them from State agencies and departments. I firmly believe that we and State authorities share common goals, and we have invited State officials to enter into cooperative, information sharing agreements regarding consumer complaints. I am confident there are ways we can improve how complaints are

[48] For examples of our enforcement actions, *see supra* pages 20-25.

[49] *See* attached chart.

handled and consumer concerns are identified and resolved, and we welcome further dialogue with State officials to further those goals.

2. The OCC is not taking on a "new role" or assuming a "longstanding responsibility" of the States to enforce State consumer protection laws.

The statutory authority for the OCC's exclusive visitorial powers does not distinguish between visitorial powers for safety and soundness, consumer compliance, operational risk, or any other type of risk faced by a national bank.[50] Given the importance of preventing abusive lending practices, some have nonetheless asserted that State and local laws should apply in addition to the Federal standards to which national banks are subject. They believe that State and local regulators should also involve themselves in supervising the activities of national banks. These critics are asking, in effect, "Isn't it better to have more regulation and more regulators?"

The answer is "Not necessarily." More regulation and more regulators can have their own consequences and are not the answer unless there has been a failure of the existing regulatory regime. That is simply not the case with national banks and their respective subsidiaries.

Adding layers of regulation brings added costs, which may lead to higher prices for customers. It may also have other undesirable collateral consequences, such as diminished product availability. For example, State and local laws that increase a bank's costs and its potential liabilities in connection with subprime loans, which are already high risk, inevitably will cause

[50] The Riegle-Neal Act bolsters this conclusion, specifically providing that if State community reinvestment, consumer protection, and fair lending laws are not preempted and are applicable to interstate branches of a national bank, those laws are enforced by the OCC. 12 U.S.C. § 36(f)(1).

some legitimate lenders to conclude that the cost and risks are not worth it. The result is diminished credit availability, and legitimate credit options that may otherwise be available to a segment of potentially credit-worthy sub-prime borrowers will be reduced. We believe our approach to combating abusive lending practices does not diminish credit *access* but does effectively target credit *abuses*.

Adding additional *regulators* also has implications. The typical responsibilities of a State Attorney General include prosecuting Medicaid fraud, investigating and prosecuting organized crime, enforcing the State's environmental protection laws, overseeing the integrity of charitable organizations, investigating and litigating civil rights complaints, advocating for consumers stymied by Health Maintenance Organizations (HMOs), enforcing the State's securities laws to combat fraud – the list could literally go on for pages. I have already described the many types of businesses, in addition to banks, that are the responsibility of State banking departments.

Given State budget constraints, State authorities' insistence on trying to add national banks to their already substantial roster of responsibilities is likely to have unfortunate consequences. The allocation of State resources to supervisory and enforcement functions that are already being performed at the Federal level means that those resources will not be used to protect the State's consumers in connection with all the other potential sources of problems those consumers face. The net result is to diminish the availability of State resources to protect consumers in *other* areas – other areas where there *is* evidence of abusive lending – other areas that are not as highly regulated as the banking business.

The OCC's approach to shared responsibilities actually maximizes regulatory oversight to protect consumers. More resources would be deployed to protect more consumers if States apply their resources to the conduct of State supervised entities, the OCC applies its resources to national banks, and State officials refer problems involving national banks that come to their attention to the OCC.

3. The preemption and visitorial powers rules will not demolish the dual banking system.

Some critics have suggested that by codifying in regulations the exclusivity of the OCC's supervision of national banks and the types of State laws that are, or are not, preempted as applied to national banks, the OCC "will demolish" the dual banking system, or "deprive bankers of a choice of charters." We even heard recently that a State legislator was told that our regulation would lead to dismantling of his State's banking department because it would prevent that department from regulating *State banks.*

Some of this rhetoric is, obviously, fanciful. Other comments in the same vein profoundly short-change the qualities of the State banking systems. More fundamentally, the argument being advanced is simply 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. 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 national and State charters each have their own distinct advantages. Indeed, today State banking regulators vigorously assert that the State charter is superior. But many national banks engage in multi-state businesses that may particularly benefit from 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, and predictable, uniform, consistent regulation. It is important to remember that the dual banking system offers American consumers a choice -- those who believe the State system offers greater protections, or desirable variety, are free to make that choice.

4. The preemption rule is not a dramatic departure from established, recognized preemption standards and case law.

Some critics of the regulation have claimed that we are using incorrect preemption standards in our preemption rule. They argue that preemption should only occur when State law significantly impairs a national bank's *express* rights under Federal law. These critics also argue that the OCC contends that national banks are immune from State law. These assertions misunderstand the final rule and incorrectly characterize both the OCC's position and the relevant judicial standards for preemption.

First, it is useful to recap how the preemption provisions of the new rule work. The rule addresses the applicability of certain types of State laws to national banks' lending, deposit-taking, and other Federally authorized activities. With regard to all three categories, the rule states the general principle that, except where made applicable by Federal law, State laws do not apply to national banks if they "obstruct, impair, or condition" the bank's exercise of powers granted under Federal law. The rule's preamble makes very clear that these words are not designed to create a new standard of preemption, but rather to distill the various phrases the Supreme Court has used in its preemption decisions.[51] As stated, the phrase does not refer to any particular type of State law and, thus, obviously does not preempt any particular law. By contrast, in the lending and deposit-taking areas, the preemption rule lists certain specific types of State laws that are preempted. In other words, the rule preempts the types of laws described in the rule; other types of laws remain subject to case-by-case evaluation under judicially developed standards, which the rule distills with the phrase "obstruct, impair, or condition." Collectively, the laws listed are virtually identical to those listed as preempted with respect to Federal thrifts in existing regulations of the OTS; many of those listed are *already preempted by virtue of existing OCC regulations*, or have been addressed by OCC preemption opinions or judicial decisions.

The OCC is *not* arguing that national banks are immune from State law. The preemption principles referenced in our new regulation are firmly grounded on standards announced by the Supreme Court and other Federal courts in cases as recent as last year, going back over 130 years, and our authority to adopt the rule is solidly based on our statutes. The final regulation specifically – and meticulously – explains the sources of our authority to issue the regulation and the standards we reference. In a nutshell, the preemption standards derive from Supreme Court and lower Federal court precedents that provide that Federal law can preempt State laws that obstruct (stand as an obstacle), *Hines v. Davidowitz (1941);* impair the efficiency of, *National Bank v. Commonwealth (1869), Davis v. Elmira Savings Bank (1896), McClellan v. Chipman (1896);* or condition the ability of national banks to exercise powers granted under Federal law,

[51] 69 Fed. Reg. at 1910.

Barnett Bank of Marion County v. Nelson (1996); Franklin National Bank (1954); and that State "legal infrastructure" laws – such as contract, torts, and real property laws -- that do not restrict the content or extent of powers granted under Federal law are **not** preempted. *National Bank v. Commonwealth (1869); McClellan v. Chipman (1896); B of A v. City and County of S.F. (9th Cir. 2002).*

5. There is no presumption against preemption in the case of the national banking laws, as confirmed by Federal case law and the Riegle-Neal Act.

Critics of both the preemption and visitorial powers rules contend that the rules are inconsistent with the presumptive application of State law to national banks, which is embodied in the Riegle-Neal Act. This is incorrect.

As an initial matter, 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 Supreme 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."[52] 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 the preemption of State law is inapplicable."[53] Indeed, when analyzing

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

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

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."[54]

The relevant text of the Riegle-Neal Act is fully consistent with these conclusions. As explained in the preamble to the visitorial powers rule, 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."*** The potential preemption of State laws thus was expressly recognized as possible in the Riegle-Neal legislation itself.

Moreover, the 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.

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[54] *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."

Id. at 34 (emphasis in original) (citations omitted).

Finally, as I mentioned at the outset, 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."* Thus, the Riegle-Neal Act is entirely consistent with the visitorial powers rule in providing that when State law is applicable to interstate branches of national banks, the OCC is to enforce such laws (in other words, the OCC retains exclusive visitorial authority).

6. The OCC has ample authority to adopt the preemption rule.

As mentioned previously, the OCC's authority to issue the preemption regulation comes from both 12 U.S.C. § 371 (regarding real estate lending) and § 93a (for all other activities). This statutory authority was recognized by the D.C. Circuit two decades ago in *CSBS v. Conover*.[55] In that case, the court expressly held that the Comptroller has the power under § 371 to issue a regulation that preempts aspects of State laws regarding real estate lending and has authority under § 93a more generally to issue regulations preempting State laws that are inconsistent with the activities permissible under Federal law for national banks. In the words of the court:

> 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*.[56]

[55] 710 F.2d 878 (D.C. Cir 1983).

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

The authority under sections 93a and 371 described by the court in *CSBS v. Conover* amply supports the adoption of regulations providing that specified types of State laws purporting to govern and curtail national banks' lending and deposit-taking activities are preempted.

7. State law applies to national bank operating subsidiaries to the same extent as their parent banks; therefore, the preemption and visitorial powers rules apply to national banks and their operating subsidiaries equally.

As explained previously, the preemption and visitorial powers rules make no changes to the OCC's rules governing the activities of operating subsidiaries. As already set out in 12 C.F.R. §§ 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, except where Federal law provides otherwise, *e.g*, functional regulation of insurance and securities subsidiaries. Therefore, *by virtue of regulations already in place*, the rules apply equally to national banks and their operating subsidiaries.

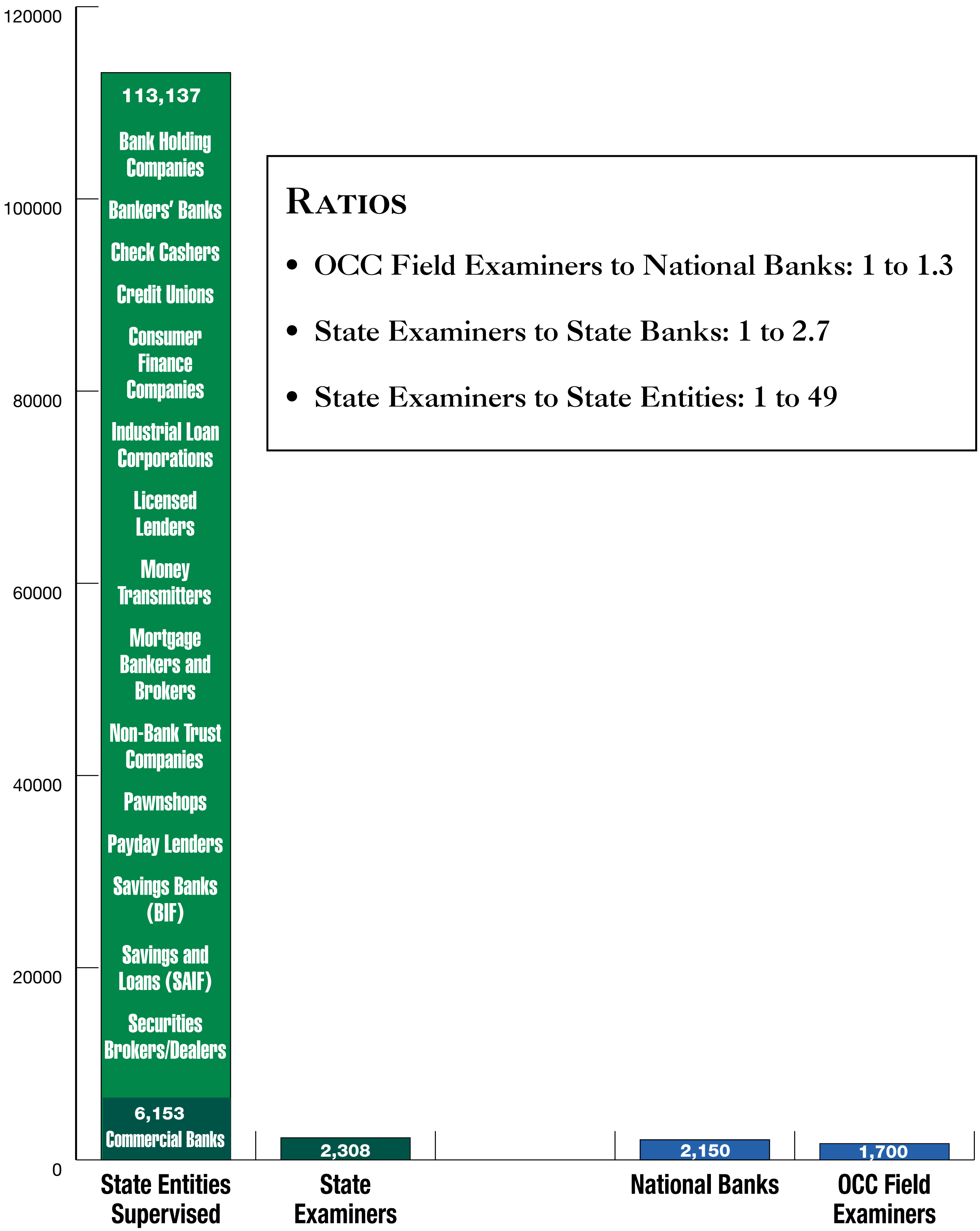
It is important to note that the OCC's position does not implicate the corporate existence or governance rules of State corporations; it concerns the ability of national banks to conduct activities through those entities subject to *Federal* supervision and regulation. National banks conduct authorized activities through operating subsidiaries pursuant to a *Federal license* under OCC regulations and Federal law, and do not need a State license to conduct activities they are authorized to conduct under a *Federal* permit. Operating subsidiaries are thus a Federally authorized means by which national banks may conduct activities authorized under Federal law; as reflected in the OCC's rules, State laws in conflict with that authority must give way.

V. <u>Conclusion</u>

In conclusion, Mr. Chairman, we believe our new regulations provide benefits for national banks and protections for national bank customers and are entirely consistent with the fundamentals of the dual banking system. Our actions also are entirely consistent with Congress's design of the national banking system, the powers and authority Congress has vested in national banks, with legal precedent dating from the earliest years of the national banking system up to current times, and with the OCC's responsibilities to ensure not only the safety and soundness of national banks but also fair treatment of their customers.

Once again, thank you, Mr. Chairman, for this opportunity to present the OCC's views.

Comparison of OCC and State Examiner Resources



Ratios

- OCC Field Examiners to National Banks: 1 to 1.3
- State Examiners to State Banks: 1 to 2.7
- State Examiners to State Entities: 1 to 49

2003 Referrals of Consumer Complaints