RESCINDED

OCC 2003-35

Subject: Bank Activities and Operations; and Real Estate Lending and Appraisals
Date: August 7, 2003

To: Chief Executive Officers of All National Banks, Federal Branches and Agencies, Department and Division Heads, and All Examining Personnel

Description: Notice of Proposed Rulemaking

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Proposed revisions to parts 7 and 34 would add provisions clarifying the applicability of state law to national banks. These provisions would identify types of state laws that are preempted, as well as types of state laws that generally are not preempted, in the context of national bank lending, deposit-taking, and other authorized activities.

In recent years, the OCC has received numerous inquiries concerning the applicability of state law to national banks and the extent to which state law applies to a national bank's exercise of powers authorized by federal law. This issue has been the subject of litigation in different contexts. Due to the number and significance of the questions that continue to arise with respect to the preemption of state laws in these areas, the OCC believes it is now timely to provide more comprehensive standards regarding the applicability of state laws to lending, deposit-taking, and other authorized activities of national banks.

The proposal would add an explicit safety-and-soundness-based, anti-predatory-lending standard to the general statement of authority concerning real estate lending in 12 CFR 34 and other lending in 12 CFR 7. As proposed, the standard would prohibit a national bank from making a loan based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources.

For further information, contact Andra Shuster, counsel, Legislative and Regulatory Activities Division at (202) 874-5090.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

Related Links

- 68 FR 46119

Proposed Rules

Federal Register
Vol. 68, No. 150
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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Rural Utilities Service

7 CFR Part 1778

RIN 0572–AB90

Emergency and Imminent Community Water Assistance Grants

AGENCY: Rural Utilities Service, USDA.

ACTION: Proposed rule.

SUMMARY: The Rural Utilities Service (RUS) is amending its regulation governing Emergency Community Water Assistance Grants (ECWAG). This action is needed to comply with requirements set forth in the 2002 Farm Bill. The intended effect is to amend the regulation so that it allows eligibility for the program to be extended to situations where an emergency is considered imminent.

In the final rule section of this **Federal Register**, RUS is publishing this action as a direct final rule without prior proposal because RUS views this as a non-controversial action and anticipates no adverse comments. If no adverse comments are received in response to the direct final rule, no further action will be taken on this proposed rule and the action will become effective at the time specified in the direct final rule. If RUS receives adverse comments, a timely document will be published withdrawing the direct final rule and all public comments received will be addressed in a subsequent final rule based on this action

DATES: Comments on this proposed action must be received by RUS via facsimile transmission or carry a postmark or equivalent no later than September 4, 2003.

ADDRESSES: Submit adverse written comments or notice of intent to submit adverse comments to F. Lamont Heppe, Jr., Program Development and Regulatory Analysis, Rural Utilities Service, U.S. Department of Agriculture, 1400 Independence Ave., SW., STOP 1522, Room 5168, South Building, Washington, DC 20250, telephone number (202) 720–9550 or via facsimile transmission to (202) 720–4120. RUS requires a signed original and three copies of all comments (7 CFR Part 1700). All comments received will be made available for inspection in room 4034, South Building, Washington, DC, between 8 a.m. and 4 p.m. (7 CFR part 1.27(b)).

FOR FURTHER INFORMATION CONTACT: Robin Pulkkinen, Loan Specialist, Water and Environmental Programs, Rural Utilities Service, Room 2229 South Building, Stop 1570, 1400 Independence Ave. SW, Washington, DC 20250–1570. Telephone: (202) 720–9636, FAX: (202) 690–0649, E-mail: *rpulkkin@rus.usda.gov.*

SUPPLEMENTARY INFORMATION: See the Supplementary Information provided in the direct final rule located in the Rules and Regulations direct final rule section of this **Federal Register** for the applicable supplementary information on this action.

Dated: July 3, 2003.

Hilda Gay Legg,

Administrator, Rural Utilities Service.

[FR Doc. 03–19697 Filed 8–4–03; 8:45 am]

BILLING CODE 3410–15–P

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 7 and 34

[Docket No. 03–16]

RIN 1557–AC73

Bank Activities and Operations; Real Estate Lending and Appraisals

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

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) proposes to amend parts 7 and 34 of our regulations to add provisions clarifying the applicability of state law to national banks. These provisions would identify types of state laws that are preempted, as well as types of state laws that generally are not preempted, in the context of national bank lending, deposit-taking, and other authorized activities.

DATES: Comments must be received by October 6, 2003.

ADDRESSES: Please direct your comments to: Office of the Comptroller of the Currency, 250 E Street, SW., Public Information Room, Mailstop 1–5, Washington, DC 20219, Attention: Docket No. 03–16, fax number (202) 874–4448; or Internet address: *regs.comments@occ.treas.gov.* Due to delays in paper mail delivery in the Washington area, we encourage the submission of comments by fax or e-mail whenever possible. Comments may be inspected and photocopied at the OCC's Public Information Room, 250 E Street, SW., Washington, DC. You can make an appointment to inspect comments by calling (202) 874–5043.

FOR FURTHER INFORMATION CONTACT: Andra Shuster, Counsel, or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities Division, (202) 874–5090.

SUPPLEMENTARY INFORMATION:

Scope of National Bank Preemption

A. Introduction

In recent years, the OCC has received numerous inquiries concerning the applicability of state law to national banks,[1] and the extent to which state law applies to a national bank's exercise of powers authorized by Federal law has been the subject of litigation in different contexts.[2] The number and variety of

[1] In response to such requests, the OCC has issued a number of interpretive opinions providing our views with respect to the applicability to national banks of various state laws. *See, e.g.,* 67 FR 13405 (Mar. 22, 2002) (Massachusetts insurance sales law); 66 FR 51502 (Oct. 9, 2001) (West Virginia insurance sales law); *see also Cline* v. *Hawke,* No. 02–2100, 2002 WL 31557392 (4th Cir. Nov. 19, 2002), petition for review dismissed (upholding OCC opinion on the merits); 66 FR 28593 (May 23, 2001) (Michigan motor vehicle sales law); 66 FR 23977 (May 10, 2001) (Ohio automobile dealer licensing law); 65 FR 15037 (Mar. 20, 2000) (Pennsylvania law governing auctioneers and the conduct of auctions); OCC Interpretive Letter No. 866 (Oct. 8, 1999) (multi-state fiduciary operations); OCC Interpretive Letter No. 872 (Oct. 28, 1999) (California restrictions on the exercise of fiduciary powers); and OCC Interpretive Letter No. 695 (Dec. 8, 1995) (multi-state fiduciary operations).

[2] *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), 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

Continued

these questions reflect a need for clarification of the circumstances when state laws or regulations apply to activities and operations of national banks. Without further clarification, national banks, particularly those with customers in multiple states, face uncertain compliance risks and substantial additional compliance burdens and expense that, for practical purposes, materially impact their ability to offer particular products and services.

A recent inquiry by National City Bank, National City Bank of Indiana, and two operating subsidiaries of these banks (collectively, National City) concerning the Georgia Fair Lending Act (GFLA)[3] illustrates the impact that state laws can have on a national bank's lending activities. Our analysis of the issues raised by National City in the response to the bank, which is discussed below and published in full elsewhere in this edition of the **Federal Register** (National City Order), underscores the need for clarity and more predictability in our regulations concerning the extent to which state laws apply to national banks' real estate lending activities as well as other aspects of national bank activities.

Due to the number and significance of the questions that continue to arise with respect to the preemption of state laws in these areas, we believe it is now timely to provide more comprehensive standards regarding the applicability of state laws to lending, deposit-taking, and other authorized activities of national banks. Accordingly, we are proposing to amend our regulations to provide such standards.

B. Principles of Preemption in the National Bank Context

Preemption is not a new concept. It is a doctrine, based on Constitutional principles, that has been recognized by the Supreme Court since the earliest years of our Nation's history. In 1819, in the landmark case of *McCulloch* v. *Maryland,* the Court held that under the Supremacy Clause of the U.S. Constitution, states ''have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations'' of an entity created under Federal law.[4] Notably, the entity involved in that case was a bank chartered under Federal law, the Second Bank of the United States. As discussed below, since the creation of the national banking system in 1863, courts have applied comparable principles of Federal preemption in connection with many aspects of national banks' operations, and have repeatedly found that the exercise by Federally-chartered national banks of their Federally-authorized powers is ordinarily not subject to state law.

1. Legislative History of the National Banking Laws

Congress enacted the National Currency Act (Currency Act) in 1863 and modified it with the National Bank Act a year thereafter for the purpose of establishing a new national banking system that would operate distinctly and separately from the existing system of state banks. The Currency Act and the National Bank Act were intended to create a uniform and secure national currency *and* a system of national banks designed to help stabilize and support the national economy both during and after the Civil War.

Both proponents and opponents of the new national banking system expected that it would replace the existing system of state banks.[5] Given this anticipated impact on state banks and the resulting diminution of control by the states over banking in general,[6] proponents of the national banking system were concerned that states would attempt to undermine it. Remarks of Senator Sumner illustrate the sentiment of many legislators of the time: ''Clearly, the [national] bank must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions.''[7]

The allocation of any supervisory responsibility for the new national banking system to the states would have been inconsistent with this need to protect national banks from state interference. Congress, accordingly, established a Federal supervisory regime and created a Federal agency within the Department of Treasury—the OCC—to carry it out. Congress granted the OCC the broad authority ''to make a thorough examination of all the affairs of [a national bank],''[8] and solidified this Federal supervisory authority by vesting the OCC with exclusive visitorial powers over national banks, except where Federal law provided otherwise. These provisions assured, among other things, that the OCC would have comprehensive authority to examine all the affairs of a national bank and protect national banks from potentially hostile state interference by establishing that the authority to examine, supervise, and regulate

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. *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).

[3] GA Code Ann. §§ 7–6A–1 *et seq.*

[4] *McCulloch* v. *Maryland,* 17 U.S. (4 Wheat.) 316, 436 (1819).

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

[6] *See, e.g., Tiffany* v. *Nat'l Bank of Missouri,* 85 U.S. 409, 412–413 (1874) (''It cannot be doubted, in view of the purpose of Congress in providing for the organization of National banking associations, that it was intended to give them a firm footing in the different States where they might be located. It was expected they would come into competition with State banks, and it was intended to give them at least equal advantages in such competition. * * * National banks have been National favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States, or to ruinous competition with State banks.''). *See also* B. Hammond, *Banks and Politics in America from the Revolution to the Civil War 725–34* (1957); P. Studenski & H. Krooss, *Financial History of the United States* 155 (1st ed. 1952).

[7] Cong. Globe, 38th Cong., 1st Sess., at 1893 (Apr. 27, 1864). *See also Beneficial Nat'l Bank* v. *Anderson,* 123 S.Ct. 2058, 2064 (2003) (''[T]his Court has also recognized the special nature of Federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system that needed protection from 'possible unfriendly State legislation.' '') (citations omitted.).

[8] Act of June 3, 1864, c. 106, § 54, 13 Stat. 116, codified at 12 U.S.C. 481.

national banks is vested *only* in the OCC, unless otherwise provided by Federal law.[9]

2. The Supremacy Clause and the Federal Preemption Standards Articulated by the Supreme Court

A state law may be preempted by Federal law and thus rendered invalid by operation of the Supremacy Clause of the Constitution.[10] The Supreme Court has identified three ways in which this may occur. First, Congress can adopt express language setting forth the existence and scope of preemption.[11] Second, Congress can adopt a framework for regulation that ''occupies the field'' and leaves no room for states to adopt supplemental laws.[12] Third, preemption may be found when state law actually conflicts with Federal law. Conflict will be found when either: (i) compliance with both laws is a ''physical impossibility;'' [13] or (ii) when the state law stands ''as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.''[14]

Because the origins of Federal preemption are Constitutional, the underlying purpose of the state legislation, no matter how salutary, does not determine the essential issue of preemption. As explained in *Association of Banks in Insurance, Inc.* v. *Duryee,*[15] ''[w]here state and federal laws are inconsistent, the state law is pre-empted even if it was enacted by the state to protect its citizens or consumers.''[16]

3. Supreme Court Precedents Leading to Barnett

From the earliest years of the national banking system, up to and including a decision rendered just months ago, the Supreme Court has consistently recognized the unique status of the national banking system and the limits placed on states by the National Bank Act.[17] In one of the first cases to address the role of the national banking system, the Supreme Court stated that ''[t]he national banks organized under the [National Bank Act] are instruments designed to be used to aid the government in the administration of an important branch of the public service. They are means appropriate to that end.''[18]

Subsequent opinions of the Supreme Court have been equally clear about national banks' unique role and status. *See Marquette Nat'l Bank of Minneapolis* v. *First of Omaha Service Corp.,* 439 U.S. 299, 314–315 (1978) (''Close examination of the National Bank Act of 1864, its legislative history, and its historical context makes clear that, . . . Congress intended to facilitate . . . a 'national banking system'.'') (citation omitted); *Franklin Nat'l Bank,* 347 U.S. at 375 (''The United States has set up a system of national banks as Federal instrumentalities to perform various functions such as providing circulating medium and government credit, as well as financing commerce and acting as private depositories.''); *Davis* v. *Elmira Sav. Bank,* 161 U.S. 275, 283 (1896) (''National banks are instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.''); *Guthrie* v. *Harkness,* 199 U.S. 148, 159 (1905) (''It was the intention that this statute should contain a full code of provisions upon the subject, and that no state law or enactment should undertake to exercise the right of visitation over a national corporation.'').

The Supreme Court also has recognized the clear intent on the part of Congress to limit the authority of states over national banks precisely so that the nationwide system of banking that was created in the Currency Act could develop and flourish. For instance, in *Easton* v. *Iowa,*[19] the Court stated that Federal legislation affecting national banks—

> has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the States. * * * It thus appears that Congress has provided a symmetrical and complete scheme for the banks to be organized under the provisions of the statute. * * * [W]e are unable to perceive that Congress intended to leave the field open for the States to attempt to promote the welfare and stability of national banks by direct legislation. If they had such power it would have to be exercised and limited by their own discretion, and *confusion would necessarily result from control possessed and exercised by two independent authorities.*[20]

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

> Being such means, brought into existence for this purpose, and intended to be so employed, the States can exercise no control over them, nor in any wise affect their operation, except in so far as Congress may see proper to permit. Any thing beyond this is ''an abuse, because it is the usurpation of power which a single State cannot give.'' [21]

Thus, as recognized by the Supreme Court in *Barnett,* the history of national bank powers is one of ''interpreting 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.''[22] ''[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.''[23]

4. Recent Lower Federal Court Decisions Concluding that State Laws Are Preempted

These principles have been recognized and applied in a series of recent cases invalidating state and local restrictions upon national bank activities that are authorized under Federal law. In each case, the court determined that the state or local restriction obstructed, in whole or in part, the exercise of an authorized

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[9] Writing shortly after the Currency Act and the National Bank Act were enacted, then-Secretary of the Treasury, and formerly the first Comptroller of the Currency, Hugh McCulloch observed that ''Congress has assumed entire control of the currency of the country, and, to a very considerable extent, of its banking interests, prohibiting the interference of State governments.'' Cong. Globe, 39th Cong., 1st Sess., Misc. Doc. No. 100, at 2 (Apr. 23, 1866).

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

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

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

[13] *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 142–43 (1963).

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

[15] 55 F. Supp. 2d 799 (S.D. Ohio 1999).

[16] *Id.* at 802. Agreeing with this conclusion, the Sixth Circuit stated that ''the fact that the state legislature enacted the [state law at issue] to protect general insurance agents and consumers does not, for that reason alone, preclude federal preemption.'' *Ass'n of Banks in Ins., Inc.* v. *Duryee,* 270 F.3d 397, 408 (6th Cir. 2001); *see also Franklin Nat'l Bank of Franklin Square* v. *New York,* 347 U.S. 373, 378 (1954).

[17] *See Beneficial Nat'l Bank,* 123 S.Ct. at 2064.

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

[19] 188 U.S. 220 (1903).

[20] *Id.* at 229, 231–232 (emphasis added).

[21] *Farmers' & Mechanics' Nat'l Bank,* 91 U.S. at 34 (citation omitted).

[22] *Barnett,* 517 U.S. at 32 (1996). The Supreme Court has recognized that the ''business of banking'' is not limited to the powers enumerated in section 24 (Seventh). *See NationsBank* v. *Variable Annuity Life Ins. Co.,* 513 U.S. 251, 258 n.2 (1995). As the scope of the underlying national bank power may evolve, the OCC ''may authorize additional activities if encompassed by a reasonable interpretation of § 24 (Seventh).'' *Indep. Ins. Agents of Am., Inc.* v. *Hawke,* 211 F.3d 638, 640 (D.C. Cir. 2000). Thus, the effect of a state law on the exercise of a Federal power may change as the character of the power changes.

[23] *Barnett,* 517 U.S. at 34.

national bank power and therefore was preempted by operation of the Supremacy Clause.

For example, ordinances passed by four municipalities in California and New Jersey specifically to prohibit ATM access fees were enjoined by district court order on grounds that included National Bank Act preemption. In California, the district court entered a preliminary injunction against the fee prohibition ordinances adopted by San Francisco and Santa Monica, and the Ninth Circuit affirmed. On remand, the district court entered a permanent injunction against the ordinances, and the Ninth Circuit once again affirmed.[24] Similarly, a Federal district court in New Jersey entered temporary restraining orders preventing fee prohibition ordinances adopted by Newark and Woodbridge from becoming effective. The combined case was ultimately settled by each city's consent to a permanent injunction against its ordinance.[25] A Federal district court in Des Moines declared a longstanding Iowa prohibition on ATM access fees to be in conflict with the national bank power to charge fees and therefore preempted.[26] For similar reasons, the Fifth Circuit upheld a Federal district court ruling that Federal law displaced a Texas statute that prohibited the charging of fees for cashing checks drawn upon accounts at the payor bank.[27] A Federal district court in Georgia reached the same conclusion with respect to a Georgia law that similarly attempted to restrict the authority of national banks under Federal law to charge such fees.[28]

Restrictions on national bank activities other than the charging of fees have also been held preempted. Deferring to the OCC's interpretations of the National Bank Act, the Eighth Circuit held that Federal law preempted Iowa restrictions on ATM location, operation, and advertising as applied to national banks.[29] More recently, a Federal district court in California permanently enjoined the California Attorney General and Director of the Department of Consumer Affairs from enforcing a California statute requiring that certain language and information be placed on the billing statements credit card issuers provide their cardholders.[30] In so doing, the Court held that there is ''no indication in the NBA that Congress intended to subject that power [to loan money on personal security] to local restriction.'' Thus, the court applied ''the ordinary rule * * * of preemption of contrary state law.''[31] Contrary state law also may be preempted by Federal regulation. ''Federal regulations have no less pre-emptive effect than federal statutes.''[32]

5. Limited Circumstances Under Which State Laws Apply to National Banks

Federal courts apply no general presumption that state laws are applicable to national banks. As explained recently by the Supreme Court, a presumption against preemption is ''not triggered when the States regulate in an area where there has been a history of significant federal presence.''[33] As further explained by the Ninth Circuit in *Bank of America,* ''because there has been a ''history of significant federal presence'' in national banking, the presumption against preemption of state law is inapplicable.''[34]

Moreover, no Federal statute endorses the presumptive application of state laws to national banks. Although the national bank branching statute makes applicable the laws of the host state regarding community reinvestment, consumer protection, and fair lending to branches of an out-of-state national bank located in the host state to the same extent as those laws apply to a bank chartered by that state, the statute expressly excepts any case where Federal law preempts the application of state law to national banks.[35]

In a few situations, Federal law has incorporated provisions of state law for specific purposes,[36] and Congress may more generally establish standards that govern when state law will apply to national banks' activities.[37] In such cases, the OCC applies the law or the standards that Congress has required or established.

State laws also may apply to national banks' activities under circumstances that have been described variously by the courts as not altering or conditioning a national bank's ability to exercise a power that Federal law grants to it.[38] ''Thus, states retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.''[39] Notably, these types of laws typically do not regulate the manner or content of the business of banking authorized for national banks under Federal law, but rather establish the legal infrastructure that surrounds and supports the conduct of that business. In other words, they promote a national bank's ability to conduct business; they do not obstruct a national bank's exercise of powers granted under Federal law.[40]

6. Examples of Types of State Laws Found to be Preempted

The OCC and Federal courts have thus far concluded that a wide variety of state laws are preempted, either because the state laws fit within the express preemption provisions of an OCC regulation or because the laws

[24] *See Bank of America, N.A.* v. *City & County of San Francisco,* 2000 WL 33376673 (N.D. Cal. June 30, 2000), aff'd, Bank of America, 309 F.3d 551.

[25] *See New Jersey Bankers Ass'n* v. *Township of Woodbridge,* No. CV–00–702 (JAG) (D.N.J. Nov. 8, 2000).

[26] *See Metrobank,* 193 F. Supp. 2d 1156.

[27] *See Wells Fargo Bank Texas,* 321 F.3d 488.

[28] *See Bank of America, N.A.* v. *Sorrell,* 248 F. Supp. 2d 1196 (N.D. Ga. 2002).

[29] *See Bank One, Utah,* 190 F.3d 844.

[30] *See American Bankers Ass'n* v. *Lockyer,* 239 F. Supp. 2d 1000 (E.D. Cal. 2002).

[31] *Id.* at 1016; *see also Wells Fargo Bank, N.A.* v. *Boutris,* 2003 WL 21277203 at *3 (E.D. Cal. May 9, 2003) (*Wells Fargo Bank II*) (The National Bank Act ''was enacted to 'facilitate * * * a national banking system,' and 'to protect national banks against intrusive regulation by the States.'") (citations omitted).

[32] *Fid. Fed. Sav. & Loan Ass'n. v. de la Cuesta,* 458 U.S. 141, 153 (1982).

[33] *United States* v. *Locke,* 529 U.S. 89, 108 (2000).

[34] 309 F.3d at 559.

[35] *See* 12 U.S.C. 36(f)(1)(A). This provision was added to the branching statute by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. 103–328, 108 Stat. 2338, 2350 (1994).

[36] *See, e.g.,* 12 U.S.C. 92a(a) (the extent of a national bank's fiduciary powers is determined by reference to the law of the state where the national bank is located).

[37] *See, e.g.,* 15 U.S.C. 6701 (codification of section 104 of the Gramm-Leach-Bliley Act, Public Law 106–102, 113 Stat. 1338, 1352 (1999), which establishes standards for determining the applicability of state law to different types of activities conducted by national banks, other insured depository institutions, and their affiliates).

[38] *See Barnett,* 517 U.S. at 33.

[39] *Bank of America,* 309 F.3d at 559. As stated in 12 U.S.C. 548, for the purposes of state tax laws, ''a national bank shall be treated as a bank organized and existing under the laws of the State * * * within which its principal office is located.'' With regard to state criminal laws, it is important to recognize the distinction drawn by the Supreme Court in Easton between ''crimes defined and punishable at common law or by the general statutes of a State'' and ''crimes and offences cognizable under the authority of the United States.'' 188 U.S. at 238. The Court stated that ''[u]ndoubtedly a State has the legitimate power to define and punish crimes by general laws applicable to all persons within its jurisdiction. * * * But it is without lawful power to make such special laws applicable to banks organized and operating under the laws of the United States.'' *Id.* at 239 (holding that Federal law governing the operations of national banks preempted a state criminal law prohibiting insolvent banks from accepting deposits). Further, as we note infra in footnote 86, we will look to the substance and effect of a state law in determining whether a particular state law falls into a category of state laws that are not preempted; a state may not immunize a law from preemption simply by applying a criminal penalty to it. Also, notably, ''[c]onsumer protection is not reflected in the case law as an area in which the states have traditionally been permitted to regulate national banks.'' Lockyer, 239 F. Supp. 2d at 1016.

[40] *See Barnett,* 517 U.S. at 33–34.

conflict with a Federal power vested in national banks. Types of state laws that have been addressed by the OCC or the courts include:

• Licensing laws. State statutes that require national banks to obtain a license or to register with the state before exercising a Federally-granted authority have been found to be preempted.[41]

• Filing requirements. State statutes that require national banks to make filings with, or report to, states conflict with the OCC's exclusive visitorial powers over national banks.[42]

• Terms of real estate loans. The OCC's current regulations in subpart A of part 34 address real estate lending generally. Section 34.4(a) expressly preempts state laws concerning five areas of fixed-rate mortgage lending. Section 34.4(a)(1) preempts state laws concerning loan-to-value ratios. Section 34.4(a)(2) preempts state laws concerning the schedule for repayment of principal and interest. In this regard, the key elements of any repayment schedule are: (1) the timing of the expected payments, and (2) the amount of expected payments.[43] Section 34.4(a)(3) preempts state laws concerning the term to maturity of real estate loans.[44] Subpart B of part 34, governing adjustable rate mortgages (ARMs), states that national banks may engage in ARM lending without regard to any state law limitation.[45]

• Advertising. Courts have consistently held that state laws limiting the ability of a national bank to advertise are preempted.[46]

• Permissible rates of interest. Federal law establishes that national banks may charge interest (both the rate and amount[47]) permitted by the state where the bank is located without regard to the laws of the state where the borrower is located.[48]

• Permissible fees and non-interest charges. Section 7.4002 of the OCC's rules outlines the framework for national banks' ability to impose non-interest fees and charges; courts have consistently held that state laws limiting the ability of national banks to charge such fees are preempted.[49]

• Management of credit accounts. The OCC has taken the position that state laws that interfere with a national bank's Federally-granted power to lend and to engage in activities incidental to its lending operations are preempted. For example, in our view, a state law that imposed restrictions or requirements that, under the *Barnett* standards, interfere with or burden a national bank's communication with its credit card holders, management of credit accounts, or terms of offers of credit was preempted. A Federal district court in California recently upheld this position.[50]

• Due-on-sale clauses. Section 34.5 of the OCC's rules and 12 U.S.C. 1701j–3 preempt state restrictions on due-on-sale clauses.

• Leaseholds as acceptable security. The provision set out in proposed § 34.4(a)(14) preempting state laws governing covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan is a restatement of the provision in current § 34.4(a)(5).

• Mandated statements and disclosures. State attempts to require national banks to make disclosures in connection with specified credit card repayment terms have been held preempted as an impermissible interference with the ability to extend credit.[51] OCC regulations already address the applicability of state law to national bank activities in some of these areas,[52] but to date, unlike the Office of Thrift Supervision (OTS),[53] we have not adopted regulations that more broadly codify the application of principles of preemption according to major groupings of activities, such as lending, deposit-taking, and other authorized bank activities. Our positions in some instances also have not clearly reflected whether we were employing an ''occupation of the field'' or ''conflicts'' approach, although our individual preemption decisions have more commonly reflected a ''conflict'' type approach to preemption analysis. The proposal clarifies the types of state law restrictions and requirements that do, and do not, apply to major types of activities and operations of national banks and, for those types of activities and operations, articulates the standards that determine whether particular types of state law restrictions and requirements are preempted.

C. Revisions to Part 34—Real Estate Lending

1. Current OCC Regulations

Part 34 of our rules implements 12 U.S.C. 371, which authorizes national banks to engage in real estate lending

[41] *See First Nat'l Bank of Eastern Arkansas* v. *Taylor,* 907 F.2d 775 (8th Cir. 1990) (the National Bank Act precludes a state regulator from prohibiting a national bank, through either enforcement action or a licensing requirement, from conducting an authorized activity); and *Bank of America Nat'l Trust & Sav. Ass'n* v. *Lima,* 103 F. Supp. 916 (D. Mass. 1952) (states have no authority to require national banks to obtain a license to engage in an activity permitted to them by Federal law). *See also Wells Fargo Bank, N.A.* v. *Boutris,* 252 F. Supp. 2d 1065, 1074 (E.D. Cal. 2003 (*Wells Fargo Bank I*) (bank becoming a state licensee does not affect its right to conduct Federally permissible banking activities authorized by the OCC); *Nat'l City Bank of Indiana* v. *Boutris,* Civ. No. S–03–0655-GEB JFM at 14 (May 7, 2003) (when banking activities are governed by Federal preemption, Federal law applies even where an instrumentality of a national bank has needlessly subjected itself to state licensing law); Letter dated May 15, 2001 from Julie L. Williams to Messrs. Thomas Plant and Daniel Morton (66 FR 28593, May 23, 2001) (regarding state license requirement in the sale of motor vehicles); Letter dated Mar. 7, 2000, from Julie L. Williams to Thomas P. Vartanian (65 FR 15037, Mar. 20, 2000) (regarding Pennsylvania auctioneer licensing law); OCC Interpretive Letter No. 866 (Oct. 8, 1999) (regarding state laws requiring national bank to obtain license before soliciting or engaging in proposed fiduciary arrangements); OCC Interpretive Letter No. 749 (Sept. 13, 1996) (regarding state law requiring national banks to be licensed to sell annuities); and OCC Interpretive Letter No. 644 (Mar. 24, 1994) (regarding state registration and fee requirements imposed on mortgage lenders). While several precedents cited address activities other than real estate lending, the principles articulated in the precedents apply to all national bank activities, including making real estate loans.

[42] *See* OCC Interpretive Letter No. 616 (Feb. 26, 1993) (state statute requiring national banks to report quarterly to state banking commissioner would be preempted based upon OCC's exclusive visitorial powers); and OCC Interpretive Letter No. 614 (Jan. 15, 1993) (state statutes requiring national banks to keep records and file notifications and data with the state would be preempted because they purport to grant the state visitorial powers over national banks); *See, e.g., Guthrie,* 199 U.S. 148 (discussing OCC's exclusive visitorial powers).

[43] *See* Section III. A. 1. of the National City Order, in which we concluded that state laws governing balloon payments, negative amortization, limitations on advance payments, late fees, prepayment fees, and default rates of interest were preempted because they concerned the schedule for repayment of principal and interest in contravention of 12 CFR 34.4(a)(2).

[44] *See id.* at Section III. A. 2., in which we concluded that state laws governing acceleration of indebtedness and rights to cure a default were preempted because they concerned the term to maturity in contravention of 12 CFR 34.4(a)(3).

[45] *See* 12 CFR 34.21(a).

[46] *See Franklin Nat'l Bank,* 347 U.S. 373 (state law restricting national bank's ability to advertise its services held preempted); *Bank One, Utah,* 190 F.3d 844 (state law limiting the placement of advertising on ATMs held preempted). *See also* OCC Interpretive Letter No. 789 (June 27, 1997) (a state law that prohibited the use of a bank's name on ATMs unless the bank put the names of all other banks whose customers may use the ATM was preempted).

[47] *See* 12 U.S.C. 1735f–7a; *Wells Fargo Bank II,* 2003 WL 21277203.

[48] *See* 12 U.S.C. 85; 12 CFR 7.4001. *See, e.g., Marquette Nat'l Bank,* 439 U.S. 299; *Tiffany,* 85 U.S. 409 (construing 12 U.S.C. 85). *See also* Section III. B. of the National City Order.

[49] *See Bank of America,* 309 F.3d 551, *Wells Fargo Bank, Texas,* 321 F.3d 488, and *Metrobank,* 193 F. Supp. 2d 1156. *See also* Section III. C. of the National City Order.

[50] *See* Lockyer, 239 F. Supp. 2d 1000.

[51] *See id.*

[52] *See, e.g.*, 12 CFR 7.4001 (interest); 7.4002 (fees); 7.4006 (operating subsidiaries); 9.7 (fiduciary activities); 34.4 (real estate lending generally); 34.5 (due-on-sale clauses); 34.21 (adjustable-rate mortgage lending); and 34.23 (prepayment fees).

[53] *See* 12 CFR 557.11–.13; 12 CFR 560.2; and 12 CFR 545.2.

subject to ''such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.'' Under subpart A of part 34 (which sets forth the general authority for national banks to engage in real estate transactions), state laws concerning five enumerated areas already are explicitly preempted in their application to national banks and their operating subsidiaries. 12 CFR 34.1(b) and 34.4(a). Section 34.4(b) then states that the OCC will apply recognized principles of Federal preemption in considering whether state laws apply to other aspects of real estate lending by national banks.

2. Codification of Preemption

Pursuant to our authority under section 371, the proposal amends § 34.4(a) and (b) to provide a more complete statement of the types of state law restrictions and requirements that do, and do not, apply to real estate lending activities of national banks. However, as recognized by the Supreme Court, Federal law may preempt state law expressly (by an express statement of preemption in the law) or implicitly (because the Federal law is so complete that it ''occupies the field'' or because the state law conflicts with a Federal power). Although the regulation proposed today would address state laws by *type,* for reasons discussed below, we invite comment on whether our regulations, like those of the OTS,[54] should state explicitly that Federal law occupies the entire field of national banks' real estate lending activities.[55]

Section 371 provides a broad grant of authority to national banks to engage in real estate lending. The only qualification in the statute is that these Federal powers are subject ''to section 1828(o) of this title [which requires the adoption of uniform Federal safety and soundness standards governing real estate lending] and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.''[56] On its face, section 371 does not condition the grant of authority to national banks to engage in real estate lending upon engaging in that activity only to the extent that a state permits it.

The breadth of the Federal power and the OCC's rulemaking authority created by section 371 can be understood by comparing the text and structure of that section to that of 12 U.S.C. 92, a statute similar in both respects and one that vests comparably broad rulemaking authority in the OCC. In *Barnett,* the Supreme Court analyzed the extent to which section 92 leaves room for state regulation of the activities the statute authorizes, and is thus instructive for purposes of analyzing section 371. The Supreme Court stated that—

[section 92's] language suggests a broad, not a limited, permission. That language says, without relevant qualification, that national banks ''may . . . act as the agent'' for insurance sales. 12 U.S.C. 92. It specifically refers to ''rules and regulations'' that will govern such sales, while citing as their source not state law, but the Federal Comptroller of the Currency.[57]

The Court noted that ''[i]n defining the pre-emptive scope of statutes and regulations granting a power to national banks, [prior U.S. Supreme Court decisions] take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.''[58] The Supreme Court concluded that ''where 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.''[59]

This analysis of section 92 by the Supreme Court is instructive in addressing section 371 as well. Like section 92, section 371 creates a broad power for national banks. By its terms, section 371 also is not a limited permission, that is, it does not authorize national banks to engage in real estate lending only to the extent state law allows.[60] Moreover, section 371 differs from section 92 in two respects that are even more telling. First, section 371 refers expressly and exclusively to the OCC as the entity possessing authority to set *restrictions* and *requirements* that apply to national banks' real estate lending activities. Second, unlike the activity to which section 92 pertains—the sale of insurance—which historically has been predominantly regulated at the state level, national bank real estate lending authority has been extensively regulated at the *Federal* level since the power first was codified.

Beginning with the enactment of the Federal Reserve Act of 1913, national banks' real estate lending authority has been governed by the express terms of section 371. As originally enacted in 1913, section 371 contained a limited grant of authority to national banks to lend on the security of ''improved and unencumbered farm land, situated within its Federal reserve district.''[61] In addition to the geographic limits inherent in this authorization, the Federal Reserve Act also imposed limits on the term and amount of each loan as well as an aggregate lending limit. Over the years, section 371 was repeatedly amended to broaden the types of real estate loans national banks were permitted to make, to expand geographic limits, and to modify loan term limits and per-loan and aggregate lending limits.

In 1982, Congress removed these ''rigid statutory limitations''[62] in favor of a broad provision authorizing national banks to ''make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation.''[63] The purpose of the 1982 amendment was ''to provide national banks with the ability to engage in more creative and flexible financing, and to become stronger participants in the home financing market.''[64] In 1991, Congress removed the term ''rule'' from this phrase and enacted an additional requirement, codified at 12 U.S.C. 1828(o), that national banks (and other insured depository institutions) conduct real estate lending pursuant to uniform standards adopted at the Federal level by regulation of the OCC and the other Federal banking agencies.[65] Thus, the history of national banks' real estate lending activities under section 371 is one of extensive Congressional involvement gradually giving way to a streamlined approach in which Congress has delegated broad rulemaking authority to the Comptroller. The two versions of section 371—namely, the lengthy and prescriptive approach prior to 1982 and the more recent statement of broad authority qualified only by reference to Federal law—may be seen as evolving articulations of the same idea.

[54] *See* 12 CFR 560.2.

[55] This issue was raised by National City in its request concerning the GFLA. As explained in the National City Order, we deferred expressing any views on the field preemption issue until we could seek comment in connection with a rulemaking rather than a decision confined to the law of a single state.

[56] 12 U.S.C. 371(a).

[57] *Barnett,* 517 U.S. at 32.

[58] *Id.* at 33.

[59] *Id.* at 34.

[60] *See id.* at 31–32.

[61] Federal Reserve Act, ch. 6, section 24, 38 Stat. 251, 273 (1913).

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

[63] Garn-St Germain Depository Institutions Act of 1982, Public Law 97–320, § 403, 96 Stat. 1469, 1510–11 (1982).

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

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

Prior to 1982, the field of national bank real estate lending was pervasively regulated by the detailed statutory provisions of section 371. After the 1982 amendment, Congress left open the possibility that the OCC would occupy the field by regulation. The statute granted the Federal power and directed that not just ''requirements'' for the exercise of the power, but any ''restrictions'' on the power, would come from the OCC. In no respect does the statute express or imply that the power granted is limited, to some variable degree, by application of fifty different state laws.

Although this authority arguably enables the OCC to occupy the field of regulation of national banks' real estate lending, thus far we have not exercised the full authority inherent in section 371. Instead, in § 34.4(a) we have provided that certain types of state requirements and restrictions are not applicable to national banks and have elected to address whether other types of laws are preempted based on the existence of a conflict between a particular state or local law and national banks' Federal power under section 371. Since section 371 conditions the exercise by a national bank of its Federal power to engage in real estate lending only on compliance with Federal law, however, our regulation is more conservative than what the statute arguably allows.

The regulation we propose today further implements our authority under section 371 to identify types of state law restrictions concerning real estate lending that are, and are not, applicable to national banks. We have chosen to identify additional types of state laws that, in various respects, obstruct or condition national banks' exercise of real estate lending powers granted under section 371. As noted above, many of these types of laws have previously been addressed in OCC interpretations or Federal court decisions. We note, however, that our authority under section 371 is not necessarily limited to specifying types of law restrictions that are applicable or inapplicable, nor does section 371 appear to necessitate that the state laws specified be only those that in some manner obstruct or condition national banks' exercise of their powers under section 371. Thus, we invite comment on whether our regulation should state expressly that Federal law occupies the entire field of national bank real estate lending.

3. Federal Safeguards

Preemption of state laws governing national banks' real estate lending does not mean that that activity would be unregulated. On the contrary, national banks' real estate lending is pervasively regulated under Federal standards and subject to comprehensive supervision.

This Federal framework includes standards governing, and oversight of, national banks' real estate lending activities to prevent abusive or predatory lending. In addition to the many Federal statutory standards that apply to national banks, the OCC recently issued comprehensive supervisory standards to address predatory and abusive lending practices. *See* OCC Advisory Letter 2003–2, ''Guidelines for National Banks To Guard Against Predatory and Abusive Lending Practices'' (Feb. 21, 2003) and OCC Advisory Letter 2003–3, ''Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans'' (Feb. 21, 2003). The OCC standards on predatory lending make clear that national banks should adopt—and vigorously adhere to—policies and procedures to prevent predatory lending practices in direct lending and in transactions involving brokered and purchased loans.

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. AL 2003–2 also emphasizes that if the OCC has evidence that a national bank has engaged in abusive lending practices, we will review those practices to determine whether they violate specific provisions of the Federal laws, including the Homeowners Equity Protection Act of 1994 (HOEPA), the Fair Housing Act, or the Equal Credit Opportunity Act. The OCC also will evaluate whether such practices involve unfair or deceptive practices in violation of the Federal Trade Commission Act (FTC Act). Indeed several practices cited in AL 2003–2, such as equity stripping, loan flipping, and the refinancing of special subsidized mortgage loans that originally contained terms favorable to the borrower, can be found to be unfair practices that violate the FTC Act.

The OCC's second advisory, AL 2003–3, addresses concerns that have been raised about the link between predatory lending and non-regulated lending intermediaries, and the risk that a national bank could indirectly and inadvertently facilitate predatory lending through the purchase of loans and mortgage-backed securities and in connection with broker transactions. Pursuant to our standards, a national bank needs 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. AL 2003–3 also advises 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.

Evidence that national banks are engaged in predatory lending practices is scant. Based on the dearth of such information—from third parties, our consumer complaint database, and our supervisory activities—we have no reason to believe that national banks are engaged in such practices to any discernible degree. This observation is consistent with an extensive study of predatory lending conducted by HUD and the Treasury Department,[66] and with comments submitted in connection with an OTS rulemaking concerning preemption of state lending standards by *46* State Attorneys General.[67]

More recently, a coalition of State Attorneys General repeated the same view in a brief filed earlier this year in connection with a challenge to that OTS rulemaking.[68] In supporting the OTS's

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

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

Departments of Housing and Urban Development and the Treasury, ''Curbing Predatory Home Mortgage Lending: A Joint Report'' 17–18 (June 2000) (Treasury-HUD Joint Report).

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.

[67] *Cited in Nat'l Home Equity Mortgage Ass'n v. OTS,* Civil Action No. 02–2506 (GK) (D.D.C. 2003) at 26.

[68] The case involves a revised regulation issued by the OTS to implement the Alternative Mortgage Transaction Parity Act (AMTPA). The revised

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decision to distinguish between supervised depository institutions and unsupervised housing creditors and to retain preemption of state laws with respect to the former but not for the latter, the State Attorneys General stated:

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

Brief for Amicus Curiae State Attorneys General, *National Home Equity Mortgage Association* v. *OTS,* Civil Action No. 02–2506 (GK) (D.D.C.) at 10–11 (emphasis added).

Against this background, the OCC's approach to predatory lending, embodied in the anti-predatory lending standards discussed above, implemented through the OCC's comprehensive supervision of national banks, minimizes the potential for harm from predatory or abusive lending without reducing the credit available to subprime borrowers. By focusing on lending practices rather than banning specific lending products, this approach reduces the likelihood of predatory lending rather than the availability of credit to subprime borrowers.

Notwithstanding the foregoing, there are certain principles that should be fundamental to all real estate lending by national banks. First is the principle that national banks should not make loans when they lack a reasonable basis to believe that the borrower has the capacity to repay the loan. This standard addresses a central characteristic of predatory lending, namely, lending based on the foreclosure value of the collateral rather than on the borrower's ability to make the scheduled payments under the terms of the loan, based on consideration of the borrower's current and expected income, current obligations, employment status, and other relevant financial resources. In such a situation, the lender is effectively relying on its ability to seize the equity in the borrower's collateral—often the borrower's home—to satisfy the outstanding debt.[69]

To prevent this, the proposal would prohibit a national bank from making a loan based predominantly on the foreclosure value of the borrower's collateral. Such practices are inconsistent with safe and sound banking and antithetical to the OCC's expectations concerning the prudence and integrity with which national banks do business. The proposal would establish a uniform, national standard, applicable to all national banks and their operating subsidiaries that, consistent with existing OCC guidance,[70] would prohibit this essential characteristic of predatory lending.

A second principle is that national banks should treat all their customers fairly and honestly. National banks' lending activities also are subject to provisions of section 5 of the FTC Act that prohibit unfair or deceptive practices in connection with real estate lending (as well as other activities authorized for national banks).[71] Section 5 serves as a standard to ensure that national banks conduct all their activities free from unfair or deceptive practices.

Practices may be found to be deceptive and thereby unlawful under section 5 of the FTC Act if three factors are present.[72] First, practices will be deceptive if there is a representation, omission, act, or practice that is likely to mislead. Practices that can be misleading or deceptive include false oral and written representations; misleading claims about costs or benefits of services or products; use of bait-and-switch techniques; and failure to provide promised services or products.

Second, a practice may be found to be deceptive if the act or practice would be deceptive from the perspective of a reasonable consumer. In this context, a reasonable consumer is a member of the group targeted by the acts or practices in question. The totality of the circumstances and the net impression that is made will be evaluated in making this determination. Failure to provide information also may be a deceptive act or practice and will be evaluated from the perspective of whether a reasonable consumer is likely to have been misled by the omission. In this regard, a consumer's reaction to an act or practice may be reasonable even if it is not the only reaction that a consumer might have.

Third, in order for a practice to be found to be deceptive, it must be material. A material misrepresentation or practice is one that is likely to affect a consumer's choice or conduct concerning a product or service. Consumer injury is likely if inaccurate or omitted information is important to the consumer's decision. Generally, information, or omission of information, about costs, benefits, purpose, and efficacy (including significant limitations) related to the product or service would be material.

A practice may be found to be unfair and thereby unlawful under section 5 of the FTC Act if the following factors are present.[73] First, the practice causes substantial consumer injury. Generally, monetary harm, such as when a consumer pays a fee or interest charge, or incurs other similar costs to obtain a bank product or service as a result of an unfair practice, is deemed to involve substantial injury. Second, the injury is not outweighed by benefits to the consumer or to competition. To be unfair, a practice must be injurious in its net effects. Third, the injury caused by the practice is one that consumers could not reasonably have avoided. Consumer harm caused by a practice that is coercive or that otherwise effectively inhibits the consumer from making an informed choice would be considered not reasonably avoidable.

Credit practices commonly referred to as predatory, such as loan ''flipping,''

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regulation distinguishes between Federally-supervised thrift institutions and non-bank mortgage lenders, making non-bank mortgage lenders subject to state law restrictions on prepayment penalties and late fees. *See id.*

[69] *See, e.g.*, Treasury-HUD Joint Report, *supra* note 66. The report notes that while factors such as the overall size of the loan, the borrower's credit history, and the value of the collateral also play into the decision, ''[a] creditor's decision on whether to originate a mortgage loan should be guided by his/her assessment of the borrower's ability to repay the loan from liquid sources (*e.g.*, income and non-housing assets).'' *Id.* at 76. The report goes on to note that ''[t]here is widespread concern * * * that some unscrupulous creditors are making loans to borrowers who clearly cannot afford to repay them.'' *Id.* The report notes further that the results of predatory lending are ''loans with onerous terms and conditions that the borrower often cannot repay, leading to foreclosure or bankruptcy.'' *Id.* at 17.

[70] *See* AL 2003–2, which, as explained above, provides supervisory guidance concerning predatory and abusive lending practices. AL 2003–2 contains a recommendation that national banks establish specific policies and procedures for underwriting to ensure that the appropriate determination has been made that each borrower has the capacity to repay his or her loan. *See id.* at 7–8.

[71] *See* 15 U.S.C. 45(a)(1). *See also* AL 2003–2. Courts recently have confirmed the application of the FTC Act to national banks. *See, e.g., Minnesota* v. *Fleet Mortgage Corp.,* 181 F. Supp. 2d 995, 1002 (D.Minn. 2001); *Roberts* v. *Fleet Bank,* 2001 WL 1486226, *2 (E.D.Pa. 2001). The Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System recently issued statements recognizing the application of section 5 of the FTC Act to the state banks within each agency's respective jurisdiction. *See* FIL–57–2002, issued by the FDIC May 30, 2002; Letter from Chairman Greenspan to the Hon. John J. LaFalce, May 30, 2002.

[72] These principles are derived from the Policy Statement on Deception, issued by the Federal Trade Commission on October 14, 1983.

[73] These principles are derived from the Policy Statement on Unfairness, issued by the Federal Trade Commission on December 17, 1980.

equity ''stripping,'' and the refinancing of special subsidized mortgage loans, may well be indicative of practices that are unfair or deceptive practices that violate section 5 of the FTC Act.[74] For example, loan flipping is generally understood to mean the refinancing of a loan, which results in little or no economic benefit to the borrower, for the primary or sole objective of generating additional loan points, loan fees, prepayment penalties, and fees from financing the sale of credit-related products.[75] Loan flipping can have particularly harmful results when it involves the practice of encouraging refinancing of special mortgage loans that contain nonstandard payment terms beneficial to the borrower, such as those originated in conjunction with a subsidized governmental or nonprofit organization program, when such refinancing entails the loss of one or more of the beneficial loan terms or is otherwise detrimental to the borrower.[76] Home equity stripping typically involves making loans with excessively high, up-front fees that are financed and secured by the borrower's home, often with an excessively high penalty upon prepayment of the loan, for the sole or primary objective of stripping the borrower's home equity.[77] Because the nature and impact of such practices are inherently highly fact-specific, the application of the standards of section 5 and use of the OCC's authority to enforce compliance with those standards are a particularly appropriate approach to ensure that such practices are not occurring in the national banking system.[78]

Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818, provides the OCC with the authority to bring enforcement actions against national banks and their subsidiaries for violations of *any* law or regulation, which necessarily includes section 5 of the FTC Act.[79] The OCC has taken enforcement actions against banks involved in practices the OCC believed were unfair or deceptive and will continue to exercise its enforcement authority in this area where appropriate. Thus, while many types of state laws are not applicable to national banks' deposit-taking and lending activities, the OCC's guidance, the new, national anti-predatory lending standard of the proposed rule, the OCC's enforcement of the FTC Act, and a host of other Federal regulations[80] will apply on a uniform basis to ensure that the real estate lending activities of national banks are conducted according to high standards.

4. Description of the Proposed Amendments to Part 34

Current § 34.3 states the general rule that national banks may ''make, arrange, purchase, or sell loans or extensions of credit, or interests therein, that are secured by liens on, or interests in, real estate, subject to terms, conditions, and limitations prescribed by the Comptroller of the Currency by regulation or order.'' The proposal would leave this statement of the general rule unchanged, other than designating it as paragraph (a) of § 34.3.[81]

A new paragraph (b) would add an explicit safety and soundness-based anti-predatory lending standard to the general statement of authority concerning lending. As proposed, § 34.3(b) states that a national bank shall not make a loan subject to 12 CFR part 34 based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources. This requirement reflects a bedrock principle of sound banking practices and is consistent with views repeatedly expressed by the OCC concerning the safety and soundness implications arising from loans made in reliance on the foreclosure value of the borrower's home or other collateral.[82] The OCC believes that it is axiomatic that lenders following safe and sound lending practices will take reasonable steps to assure themselves and to verify that the borrower has the capacity to make scheduled payments to repay a loan, taking into account all of the borrower's obligations, including other indebtedness, insurance, and taxes, as well as principal and interest.[83]

The new prudential standard proposed in § 34.3(b), the preexisting standard under the FTC Act, which the OCC enforces, and the many other applicable Federal laws that we have mentioned, ensure that national banks are subject to consistent and uniform Federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety and soundness-based criteria for their real estate lending activities. We invite interested parties to suggest other

[74] AL 2003–2 contains guidance recommending the establishment by national banks of policies and procedures to specify whether and under what circumstances the banks will make loans involving features or circumstances that have been associated with abusive lending practices.

[75] Federal law prohibits a creditor within one year of having extended credit subject to HOEPA from refinancing that loan to another loan subject to HOEPA, unless the refinancing is ''in the borrower's interest.'' 12 CFR 226.34(a)(3).

[76] If a national bank engages in the practice of ''steering'' a borrower to a loan with higher costs instead of to a comparable loan offered by the bank with lower costs for which the borrower could qualify, and does this on the basis of the borrower's race, national origin, age, or gender, for example, the OCC will take appropriate enforcement action under the Federal fair lending laws.

[77] Frequently equity stripping occurs in connection with loan flipping. ''Lenders who flip loans tend to charge high origination fees with each successive refinancing, and may charge these fees based on the entire amount of the new loan. * * * In addition, each refinancing may trigger prepayment penalties, which could be financed as part of the total loan amount, adding to the borrower's debt burden. * * * Each time the loan is flipped, more equity is lost in the home.'' Treasury-HUD Joint Report, *supra* note 66, at 73–74.

[78] Case-by-case enforcement actions by the OCC to address such predatory lending practices also is particularly appropriate because such activities appear to be limited, if not rare, in the national banking system. See Treasury-HUD Joint Report, *supra* note 66, at 13 (''[T]here is a growing body of anecdotal evidence that an unscrupulous subset of * * * subprime actors—lenders (often those not subject to federal banking supervision), as well as mortgage brokers, realtors, and home improvement contractors—engage in abusive lending practices that strip borrowers' home equity and place them at increased risk of foreclosure.'').

[79] In section 8, Congress gave the OCC broad powers to compel national banks' compliance with Federal and state laws. This includes the ability to issue cease and desist orders when the OCC determines that a national bank is violating or has violated any ''law, rule, or regulation.'' 12 U.S.C. 1818(b)(1). Recent decisions have acknowledged the OCC's authority to enforce national banks' compliance with the FTC Act. See, *e.g., Chavers* v. *Fleet Bank,* 2002 WL 481797 (R.I. Super. Feb. 25, 2002); *Rossman* v. *Fleet Bank,* C.A. No. PB01–0479 (R.I. Super. 2001) (transcript of hearing on Nov. 26, 2001, pp. 25–28). *See also Roberts,* 2001 WL 1486226 at *2.

[80] As set forth above, there is an existing network of Federal laws applicable to national banks that protect consumers in a variety of ways. For lending activities, in addition to the Truth in Lending Act (TILA), Real Estate Settlement Procedures Act, Equal Credit Opportunity Act, and the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Consumer Leasing Act, and the Fair Debt Collection Practices Act may also apply.

[81] We note that in a notice of proposed rulemaking to amend 12 CFR parts 3, 5, 6, 7, 9, 28, and 34, published on February 7, 2003, we have proposed to amend 12 CFR 34.3 to reflect the amendment to 12 U.S.C. 371 that added a reference to 12 U.S.C. 1828(o). *See* 68 FR 6363.

[82] *See, e.g.*, Testimony of John D. Hawke, Jr. Before the Committee on Banking and Financial Services of the U.S. House of Representatives, May 24, 2000; AL 2003–2. *See also* OCC Advisory Letter 2000–7 (July 25, 2000). The standard is reflected elsewhere in Federal law. HOEPA prohibits creditors from engaging in a pattern or practice of extending credit subject to HOEPA ''based on the consumers'' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment.'' 15 U.S.C. 1639(h).

[83] OCC regulations provide that a national bank must ''establish and maintain loan documentation practices that * * * [i]dentify the * * * source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner.'' 12 CFR part 30, App. A, II. C.

general standards that would be appropriate to apply to national bank real estate lending activities that would further these objectives.

State laws that are preempted. Pursuant to section 371, we propose to amend § 34.4(a) to specify more completely the types of state law restrictions and requirements that are not applicable to national banks. This list, promulgated under our authority under section 371 to prescribe the types of restrictions and requirements to which national banks' real estate lending activities shall be subject, reflects our experience with types of state laws that obstruct, in whole or in part, or condition, national banks' exercise of real estate lending powers granted under Federal law. The list is not intended to be exhaustive. Other types of state laws that similarly affect the exercise of national banks' real estate lending powers may be identified. Under the regulation, those would be addressed by the OCC on a case-by-case basis.

State laws that are not preempted. Section 34.4(b) also provides that certain types of state laws are not preempted and would be applicable to national banks to the extent that they do not materially affect the real estate lending powers of national banks or are otherwise consistent with national banks' Federal authority to engage in real estate lending.[84] These types of laws generally pertain to contracts, debt collection, acquisition and transfer of property, taxation, zoning, crimes, torts,[85] and homestead rights. In addition, any other law that the OCC determines to interfere to only an insignificant extent with national banks' real estate lending powers or is otherwise consistent with national banks' authority to engage in real estate lending would not be preempted under the proposal.[86] In general, these would be laws that do not attempt to regulate the manner or content of national banks' real estate lending, but that instead form the legal infrastructure that surrounds and supports the conduct of that business. In general, the types of laws that are not preempted are those that promote national banks' ability to conduct business, rather than obstruct national banks' exercise of their real estate lending powers.

D. Revisions to Part 7—Deposit-Taking, Other Lending, and Bank Activities

1. Background

Preemption issues arising in the context of national bank deposit-taking, other lending activities, and bank activities, while involving the application of different sources of Federal authority than that of real estate lending, nevertheless need similar rules that address more completely the types of state law restrictions and requirements that are, and are not, applicable to national banks and the standard employed to produce that result. Here, the proposal again focuses on state laws that obstruct, in whole or in part, or condition, national banks' exercise of powers granted under Federal law.[87]

This result recognizes the Federal source of national bank powers and the inherent design of the national banking system as a nationwide system of Federally-empowered banks operating under Federal standards, as discussed in section B., above.

Consistent with the purpose of establishing a national banking system subject to uniform standards, Congress has vested the OCC with broad authority to facilitate the safe and sound exercise by national banks of their Federal powers. For example, 12 U.S.C. 93a vests the OCC with the authority to ''prescribe rules and regulations to carry out the responsibilities of the office * * *,'' except ''to the extent that authority to issue such rules and regulations has been *expressly* and *exclusively* granted to another regulatory agency.''[88] Clearly, one of the ''responsibilities of the office'' is to administer the National Bank Act to enable national banks to employ the powers vested in them by Congress, free of obstacles to their ability to fully exercise those powers, and governed under the framework of Federal regulation and national standards envisioned by Congress in its design of the national banking system. The OCC fulfills this responsibility in part by setting the Federal standards under which national banks operate and clarifying when state standards do, and do not, affect their operations.

In this regard, we believe it is appropriate to provide greater certainty and clarity to national banks concerning the extent to which state laws governing deposit-taking, non-real estate lending, and other authorized bank activities are applicable to national banks. The proposed amendments thereby further the OCC's responsibility to administer the National Bank Act by allowing national banks to conduct these activities, free of the specified types of state-imposed obstacles to their ability to fully exercise their powers in these areas. The amendments also further the ability of national banks to operate pursuant to the framework of national standards envisioned by Congress and enhance the safe and sound exercise by national banks of their Federal authority to conduct the business of banking by promoting efficiency of national bank activities.

2. Description of the Proposed Amendments to Part 7

The proposal adds three new sections to part 7, § 7.4007 regarding deposit-taking activities, § 7.4008 regarding non-real estate lending activities, and § 7.4009 regarding other authorized national bank activities. The structure of the amendments is the same for §§ 7.4007 and 7.4008 and is similar for § 7.4009. For §§ 7.4007 and 7.4008, the proposed rule first sets out a statement of the authority to engage in the activity. Second, the rule notes that state laws that obstruct, in whole or in part, or condition, a national bank's exercise of powers granted under Federal law are not applicable, and lists several types of state laws that are preempted. Finally,

[84] As set forth above in note 36, there are instances where Federal law specifically requires the application of state law to national banks, such as in 12 U.S.C. 92a(a). The language used in the regulation ''unless otherwise made applicable . . . by Federal law'' refers to this type of situation. Federal statutes such as TILA that contain clauses that preserve state law from preemption by that statute do not make those state laws applicable to national banks; in fact, such state laws may still be preempted by other Federal law such as the National Bank Act. *See, e.g., Bank One, Utah,* 190 F.3d at 850; and *Bank of America,* 309 F.3d at 565.

[85] *See Bank of America,* 309 F.3d at 559 (''[S]tates retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.'').

[86] We note that the label a state attaches to its laws will not affect the analysis of whether that law is preempted. We will analyze the substance of any state law to determine whether the state law has only an incidental impact on the Federal powers. For instance, laws related to the transfer of real property may contain provisions that give borrowers the right to ''cure'' a default upon acceleration of a loan if the lender has not foreclosed on the property securing the loan. Viewed one way, this could be seen as part of the state laws governing foreclosure, which historically have been within a state's purview. However, as we concluded in the National City Order, to the extent that this type of law also limits the ability of a national bank to adjust the terms of a loan once there has been a default, it would be a state law limitation ''concerning * * * (2) The schedule for repayment of principal and interest; [or] (3) The term to maturity of the loan.'' 12 CFR 34.4(a). In such a situation, we would look to the effect of the state statute. If the primary effect of the state law is to regulate in the areas listed in our regulation, the state law would be preempted.

[87] *See Hines* v. *Davidowitz,* 312 U.S. 52, 67 (state law is preempted when it ''stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.''); *Barnett,* 517 U.S. at 33–34.

[88] 12 U.S.C. 93a (emphasis added). Section 93a also contains exceptions to our rulemaking authority in areas unrelated to deposit-taking or lending.

the rule lists several types of state laws that, as a general matter, are not preempted. In § 7.4009, the proposal first states that national banks may exercise all powers authorized to it under Federal law. Second, the proposal states that except as otherwise made applicable by Federal law, state laws that obstruct, in whole or in part, or condition, a national bank's exercise of powers granted under Federal law are not applicable. Finally, the proposal lists several types of state laws that, as a general matter, are not preempted.

As with the proposed amendments to part 34, the proposed amendment to part 7 governing non-real estate lending includes a safety and soundness-based anti-predatory lending standard. As proposed, § 7.4008(b) states that a national bank shall not make a loan described in § 7.4008 based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources. As noted in the discussion of proposed amendments to part 34, this requirement reflects a bedrock principle of sound banking practices and is consistent with views repeatedly expressed by the OCC concerning the safety and soundness implications arising from loans made in reliance on the foreclosure value of the borrower's home or other collateral.

Non-real estate lending also is subject to section 5 of the FTC Act, which makes unlawful ''unfair or deceptive acts or practices'' in interstate commerce.[89] Together, the new prudential standard proposed in § 7.4008(b) and the preexisting standard under the FTC Act, plus Federal laws such as the Truth-in-Savings Act, ensure that national banks are subject to consistent and uniform Federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety and soundness-based criteria for their deposit-taking and lending activities. We invite interested parties to suggest other general standards that would be appropriate to apply to national bank lending activities that would further these objectives.

Deposit-taking and lending are powers specifically enumerated in statute. The same Federal statute—12 U.S.C. 24 (Seventh)—also grants to national banks the broader power to engage in activities that are part of, or incidental to, the business of banking. Questions about the applicability of state law are resolved, as we have described, with reference to the Federal character of the national bank charter; the fact that national bank powers derive exclusively from Federal law; and the purposes of the National Bank Act, including Congress's creation of a ''complete'' national banking system, free from state control, and subject to uniform, national standards. In this context, the Supreme Court and the lower Federal courts have said that state laws affecting the exercise of Federally authorized powers ordinarily do not apply to national banks.[90] This is so whether the Federal grant of authority is specific, as in the case of deposit-taking or lending, or general, like the powers clause in section 24 (Seventh).

The OCC's regulations already address the applicability of state law with respect to a number of specific types of activities. The question may persist, however, about the extent to which state law may govern powers or activities that have not been addressed by Federal court precedents or OCC opinions or orders. Accordingly, proposed new § 7.4009 provides that state laws do not apply to national banks if they obstruct, in whole or in part, or condition, a national bank's exercise of powers granted under Federal law.[91]

In some circumstances, of course, Federal law directs the application of state standards to a national bank. The wording of § 7.4009 reflects the fact that a Federal statute may require the application of state law,[92] or it may incorporate—or ''Federalize''—state standards.[93] In those circumstances, the state standard applies. State law may also apply if it has only an incidental effect on a national bank's exercise of its Federally authorized powers or if it is otherwise consistent with national banks' uniquely Federal status. Like the other provisions we are proposing, § 7.4009 recognizes the potential applicability of state law in these circumstances. This approach is consistent with the Supreme Court's observation that national banks ''are governed in their daily course of business far more by the laws of the state than of the nation.'' [94] As the Ninth Circuit recently has said: ''[S]tates retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.'' [95] However, as noted previously, these types of laws typically do not regulate the manner or content of the business of banking authorized for national banks, but rather establish the legal infrastructure that surrounds and supports the conduct of that business. They promote national banks' ability to conduct business; they do not obstruct the ability of national banks to exercise their Federally-granted powers.

E. Application of Proposed Changes to Operating Subsidiaries

In accordance with our regulation set out in 12 CFR 7.4006, the rules governing national bank deposit-taking and lending apply equally to national bank operating subsidiaries. The OCC and Federal courts long have recognized that national banks may exercise permissible Federal powers through the separately incorporated operating subsidiary. Our regulations make clear that activities conducted in operating subsidiaries must be permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking.[96] Moreover, the operating subsidiary is acting ''pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank.'' [97] These regulations reflect express Congressional recognition in section 121 of the Gramm-Leach-Bliley Act that national banks may own subsidiaries that engage ''solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and

[89] 15 U.S.C. 45(a)(1).

[90] *See Barnett,* 517 U.S. at 32.

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

[92] *See, e.g.*, 15 U.S.C. 6711 (insurance activities of national banks are ''functionally regulated'' by the states, subject to the provisions on the operation of state law contained in section 104 of the Gramm-Leach-Bliley Act).

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

[94] *Nat'l Bank* v. *Commonwealth,* 76 U.S. (9 Wall.) 353, 362 (1869) (holding that shares held by shareholders of a national bank were lawfully subject to state taxation) (''All [national banks'] contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect debts, and their liability to be sued for debts, are also based on State law.'').

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

[96] *See* 12 CFR 5.34(e)(3).

[97] *Id.*

conditions that govern the conduct of such activities by national banks.'' [98] Courts have consistently treated operating subsidiaries and their parent banks as equivalents, unless Federal law requires otherwise, in considering whether a particular activity is permissible.[99]

In accordance with the longstanding regulatory and judicial recognition of operating subsidiaries as corporate extensions of the parent bank, OCC regulations specifically provide that ''[u]nless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.'' [100] The only court to have considered the application of state law to an operating subsidiary after § 7.4006 was promulgated agreed with our position.[101] We also note that the OTS takes the same approach with respect to operating subsidiaries of Federal thrifts. 12 CFR 559.3(n) of the OTS regulations provides that state law applies to Federal savings associations' operating subsidiaries to the extent that the law applies to the parent thrift. This OTS regulation was upheld by a Federal district court.[102]

Accordingly, the proposed amendments to parts 7 and 34 apply equally to operating subsidiaries of national banks.

Request for Comments

In addition to the specific issues noted previously on which comment is specifically invited, the OCC invites comment on all aspects of the proposed regulation.

Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106–102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. We invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?
- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- What else could we do to make the regulation easier to understand?

Community Bank Comment Request

In addition, we invite your comments on the impact of this proposal on community banks. The OCC recognizes that community banks operate with more limited resources than larger institutions and may present a different risk profile. Thus, the OCC specifically requests comments on the impact of this proposal on community banks' current resources and available personnel with the requisite expertise, and whether the goals of the proposed regulation could be achieved, for community banks, through an alternative approach.

Regulatory Flexibility Act

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

Pursuant to section 605(b) of the RFA, the OCC hereby certifies that this proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not needed. The amendments address the applicability of state law to national banks' deposit-taking, lending, and other authorized activities. These amendments simply provide the OCC's analysis and do not impose any new requirements or burdens. As such, they will not result in any adverse economic impact.

Executive Order 12866

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

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104–4 (2 U.S.C. 1532) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating any rule likely to result in a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC has determined that the proposed rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more in any one year. Accordingly, this rulemaking is not subject to section 202 of the Unfunded Mandates Act.

Executive Order 13132

Executive Order 13132 requires Federal agencies, including the OCC, to certify their compliance with that Order when they transmit to the Office of Management and Budget any draft final regulation that has Federalism implications. Under the Order, a regulation has Federalism implications if it has ''substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.'' In the case of a regulation that has Federalism implications and that preempts state law, the Order imposes certain consultation requirements with state and local officials; requires publication in the preamble of a Federalism summary impact statement; and requires the OCC to make available to the Director of the Office of Management and Budget any written communications submitted by state and local officials. By the terms of the Order, these requirements apply to the extent that they are practicable and permitted by law and, to that extent, must be

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[98] Pub. L. 106–102, § 121, 113 Stat. 1338, 1373 (1999), codified at 12 U.S.C. 24a(g)(3)(A).

[99] *See, e.g., NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.,* 513 U.S. 251 (sale of annuities by operating subsidiary); *Clarke* v. *Securities Industry Ass'n,* 479 U.S. 388 (1987) (securities brokerage operating subsidiary); *Marquette Nat'l Bank,* 439 U.S. 299 (credit card subsidiary); *American Ins. Ass'n* v. *Clarke,* 865 F.2d 278 (D.C. Cir. 1988) (bond insurance subsidiary); *M & M Leasing Corp.* v. *Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977) (auto leasing subsidiary); and *Valley Nat'l Bank* v. *Lavecchia,* 59 F. Supp. 2d 432 (D.N.J. 1999) (title insurance subsidiary).

[100] 12 CFR 7.4006.

[101] *See Wells Fargo Bank I,* 252 F. Supp. 2d 1065, and *Wells Fargo Bank II,* 2003 WL 21277203, granting plaintiff's motion for preliminary and permanent injunction on Supremacy Clause preemption claims, respectively. *See also Nat'l City Bank of Indiana* v. *Boutris,* Civ. No. S–03–0655 GEB JFM (E.D. Cal. May 7, 2003), and *Nat'l City Bank of Indiana* v. *Boutris,* 2003 WL 21536818 (E.D. Cal. July 2, 2003).

[102] *See WFS Financial, Inc.* v. *Dean,* 79 F. Supp. 2d 1024 (W.D. Wis. 1999); *see also Chaires* v. *Chevy Chase Bank, F.S.B.,* 748 A.2d 34, 44 (Md. App. 2000).

satisfied before the OCC promulgates a final regulation.

This proposal may have Federalism implications, as that term is used in the Order. Therefore, before promulgating a final regulation based on this proposal, the OCC will, to the extent practicable and permitted by law, seek consultation with state and local officials, include a Federalism summary impact statement in the preamble to the final rule, and make available to the Director of OMB any written communications we receive from state or local officials.

List of Subjects

12 CFR Part 7

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

12 CFR Part 34

Mortgages, National banks, Reporting and recordkeeping requirements.

Authority and Issuance

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

PART 7—BANK ACTIVITIES AND OPERATIONS

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

Authority: 12 U.S.C. 1 *et seq.*, 71, 71a, and 93a.

Subpart D—Preemption

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

§ 7.4007 Deposit-taking.

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

(b) *Applicability of state law.* (1) Except where made applicable by Federal law, state laws that obstruct, in whole or in part, or condition, a national bank's exercise of its Federally-authorized deposit-taking powers are not applicable to national banks.

(2) The types of state laws referenced in paragraph (b)(1) of this section include state laws concerning—

(i) Abandoned and dormant accounts;[3]

(ii) Checking accounts;

(iii) Mandated statements and disclosure requirements;

(iv) Funds availability;

(v) Savings account orders of withdrawal;

(vi) State licensing or registration requirements; and

(vii) Special purpose savings services.[4]

(c) Except where made applicable by Federal law, state laws on the following subjects apply to national banks to the extent that they only incidentally affect the deposit-taking activities of national banks or are otherwise consistent with the purposes set out in paragraph (a) of this section:

(1) Contracts;

(2) Torts;

(3) Criminal law; [5]

(4) Debt collection;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

(8) Any other law that the OCC, upon review, determines to have only an incidental effect on the deposit-taking operations of national banks or is otherwise consistent with the purposes set out in paragraph (a) of this section.

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

§ 7.4008 Lending.

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

(b) *Standards for loans.* A national bank shall not make a loan described in paragraph (a) based predominantly on the foreclosure value of the borrower's collateral, without regard to the borrower's repayment ability, including the borrower's current and expected income, current obligations, employment status, and other relevant financial resources.

(c) *Applicability of state law.* (1) Except where made applicable by Federal law, state laws that obstruct, in whole or in part, or condition, a national bank's exercise of its Federally-authorized non-real estate lending powers are not applicable to national banks.

(2) The types of state laws referenced in paragraph (c)(1) of this section include state laws concerning—

(i) Licensing, registration, filings, or reports by creditors;

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

(iii) Loan-to-value ratios;

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

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

(vi) Security property, including leaseholds;

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

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

(ix) Disbursements and repayments; and

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

(d) Except where made applicable by Federal law, state laws on the following subjects apply to national banks to the extent that they only incidentally affect

[3] This does not apply to state laws of the type upheld by the United States Supreme Court in *Anderson Nat'l Bank* v. *Luckett,* 321 U.S. 233 (1944), which obligate a national bank to ''pay [deposits] to the persons entitled to demand payment according to the law of the state where it does business.'' *Id.* at 248–249. State escheat laws are not included in this category. *See also* 12 CFR 557.12; 62 FR 55759, 55761 (Oct. 22, 1997).

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

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

[6] The limitations on charges that comprise rates of interest on loans by national banks are determined under Federal law. Federal law applies a state's limits on rates of interest to loans made by national banks located in that state. *See* 12 U.S.C. 85; 12 CFR 7.4001. State laws purporting to regulate national bank fees and charges that do not constitute interest are addressed in 12 CFR 7.4002.

the non-real estate lending activities of national banks or are otherwise consistent with national banks' Federal lending authority:

(1) Contracts;

(2) Torts;

(3) Criminal law; [7]

(4) Debt collection;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

(8) Any other law that the OCC, upon review, determines to have only an incidental effect on the non-real estate lending operations of national banks or is otherwise consistent with the purposes set out in paragraph (a) of this section.

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

§ 7.4009 Applicability of state law to other authorized national bank activities.

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

(b) *Applicability of state law generally.* Except where made applicable by Federal law, state laws that obstruct, in whole or in part, or condition, a national bank's exercise of powers granted under Federal law do not apply to national banks.

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

(2) Except where made applicable by Federal law, state laws on the following subjects apply to national banks to the extent that they only incidentally affect the exercise of national bank powers:

(i) Contracts;

(ii) Torts;

(iii) Criminal law;

(iv) Debt collection;

(v) Acquisition and transfer of property;

(vi) Taxation;

(vii) Zoning; and

(viii) Any other law that the OCC, upon review, determines to have only an incidental effect on the exercise of national bank powers or is otherwise consistent with purposes set out in paragraph (a) of this section.

[7] *See* note 5 in 12 CFR 7.4007 regarding the distinction drawn by the Supreme Court in *Easton* v. *Iowa*, 188 U.S. 220, 238 (1903) between ''crimes defined and punishable at common law or by the general statutes of a State'' and ''crimes and offences cognizable under the authority of the United States.''

PART 34—REAL ESTATE LENDING AND APPRAISALS

Subpart A—General

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

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

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

§ 34.3 General rule.

* * * * *

(b) A national bank shall not make a loan described in this part based predominantly on the foreclosure value of the borrower's collateral, without regard to the borrower's repayment ability, including the borrower's current and expected income, current obligations, employment status, and other relevant financial resources.

7. Section 34.4 is revised to read as follows:

§ 34.4 Applicability of State law.

(a) Except where State law is made applicable by Federal law, a national bank may make real estate loans under 12 U.S.C. 371 and § 34.3, without regard to State law limitations concerning:

(1) Licensing, registration, filings, or reports by creditors;

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

(3) Loan-to-value ratios;

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

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

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

(7) Security property, including leaseholds;

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

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

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

(11) Disbursements and repayments;

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

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

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

(b) Except where made applicable by Federal law, State laws on the following subjects apply to national banks to the extent that they only incidentally affect the real estate lending powers of national banks:

(1) Contracts;

(2) Torts;

(3) Criminal law; [2]

(4) Homestead laws specified in 12 U.S.C. 1462a(f);

(5) Debt collection;

(6) Acquisition and transfer of real property;

(7) Taxation;

(8) Zoning; and

(9) Any other law that the OCC, upon review, determines to have only an incidental effect on the real estate lending powers of national banks or is otherwise consistent with the purposes set out in § 34.3(a).

Dated: July 30, 2003.

John D. Hawke, Jr.,

Comptroller of the Currency.

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

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