Visitorial Powers Final Rule
Questions and Answers
January 7, 2004

I. INTRODUCTION

What are "visitorial powers"?

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

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

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

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

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

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

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

We have also amended the regulation text in the final rule concerning the "visitorial powers…vested in the courts of justice" exception. This provision no longer makes reference to specific powers of the courts of justice "to issue orders or writs compelling the production of information or witnesses" since that description may be too limiting. This provision now simply states that the exception pertains to powers inherent in the judiciary. The language that stated

that the exception for courts of justice does not authorize states or other governmental entities to exercise visitorial powers over national banks also has been simplified.

What does the final rule <u>not</u> do?

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

The final rule makes no change to the treatment of operating subsidiaries. An existing OCC regulation, 12 C.F.R. § 7.4006, states that "[u]nless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." Thus, states generally can exercise visitorial powers over operating subsidiaries only to the extent that they could exercise visitorial powers over a national bank.

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

II. IMPACT ON DUAL BANKING SYSTEM

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

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

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

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

Recent debate about enforcement has centered recently on the ability of states to enforce their laws against operating subsidiaries of national banks. Operating subsidiaries are Federally authorized means through which national banks can conduct business. The only court cases to decide the issue of the OCC's visitorial authority over national bank operating subsidiaries have

held that our exclusive visitorial authority – including the authority to enforce compliance with applicable law – extends to operating subsidiaries. Thus, while states are free to enforce consumer compliance laws as they apply to institutions within their primary jurisdiction, they are not free to do so in the context of national banks or their operating subsidiaries, except where Federal law authorizes them to do so.

What role may states play under the final rule?

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

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

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

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

III. AUTHORITY FOR THE RULE

A. National banks

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

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

responsibility to the states. Further, such an allocation to the states would be inconsistent with the history and purpose of the National Bank Act and judicial precedent interpreting the Act.

B. Operating subsidiaries

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

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

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

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

Didn't GLBA make clear that operating subsidiaries are explicitly NOT to be treated as part of their parent bank ?

No, to the contrary. Section 121 of GLBA recognizes the authority of national banks to own subsidiaries that engage "solely in activities that national banks are permitted to engage in directly and are conducted *subject to the same terms and conditions that govern the conduct of such activities by national banks*." This underscores the point that an operating subsidiary is treated, for regulatory and supervisory purposes, the same as its parent bank.

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

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

Under Federal law, a national bank may exercise the Federal banking powers available to it either directly in the bank or indirectly through an operating subsidiary. If the bank elects to use

an operating subsidiary, the bank is required to obtain a Federal license to do so pursuant to the procedures set forth in the OCC's regulations. Once the license is obtained, the activity will be subject to the same terms and conditions that would apply if the bank conducted the activity directly.

IV. IMPACT ON CONSUMERS

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

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

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

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

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

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

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

As previously noted, it is our hope that states will cooperate with the OCC to try to maximize the protection of consumers. We have encouraged states to work with us to expedite referrals of

consumer complaints regarding national banks from state Attorneys General and state banking departments, and have offered to enter into formal information-sharing agreements with states to formalize these arrangements.

Has the OCC ever brought a case charging predatory lending?

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

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

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

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

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