

**APPENDIX A: FEDERAL PREEMPTION OF STATE AND LOCAL FAIR LENDING
AND MORTGAGE LENDING LAWS**

I. Background of National Bank Preemption

Since its establishment in 1863 and 1864, the national banking system, operating under uniform federal standards across state lines, has fostered an open financial marketplace, the growth of national products and services in national and multi-state markets, sound operating practices and efficient product delivery to bank customers. At the core of the national banking system is the principle that national banks, in carrying on the business of banking under a Federal authorization, should be subject to uniform national standards and uniform federal supervision.¹ The legal principle that produces such a result is the “preemption” of state law.

In the years following the National Bank Act’s enactment, the Supreme Court 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 National Bank Act could develop and flourish. This point was highlighted by the Supreme Court in 1903 in *Easton v. Iowa*.² The Court stressed that the application of multiple states’ standards would undermine the uniform, national character of the powers of national banks, which operate in–

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.... If [the states] 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.³

The Supreme Court strongly reaffirmed this point in 2007 in *Watters v. Wachovia*,⁴ stating:

Diverse and duplicative superintendence [by the states] of national banks’ engagement in the business of banking, we observed over a century ago, is precisely what the [National Bank Act] was designed to prevent.⁵

The Supreme Court and lower Federal courts have repeatedly made clear that state laws that conflict, impede, or interfere with national banks’ powers and activities are preempted. For

¹ In discussing the impact of the National Currency Act and National Bank Act, Senator Sumner stated that, “[c]learly, 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.” Cong. Globe, 38th Cong., 1st Sess., at 1893 (April 27, 1864).

² 188 U.S. 220 (1903).

³ *Id.* at 229, 230-31. A similar point was made by the Court in *Talbott v. Bd. of County Commissioners of Silver Bow County*, in which the court stressed that the entire body of the Statute respecting national banks, emphasize that which the character of the system implies - an intent to create a national banking system co-extensive with the territorial limits of the United States, and with uniform operation within those limits. 139 U.S. 438, 443 (1891).

⁴ 550 U.S. 1 (2007).

⁵ *Id.* at 14.

example, in *Davis v. Elmira Savings Bank*,⁶ the Supreme Court stated: “National banks are instrumentalities of the Federal Government, . . . It follows that an attempt, by a state, to define their duties or control the conduct of their affairs, is absolutely void.” In *Franklin National Bank v. New York*,⁷ the Supreme Court held that a state could not prohibit a national bank from using the word “savings” in its advertising, since the state law conflicts with the power of national banks to accept savings deposits. More recently, in *Barnett Bank v. Nelson*,⁸ the Supreme Court affirmed the preemptive effect of Federal banking law under the Supremacy Clause and held that a state statute prohibiting banks from engaging in most insurance agency activities was preempted by Federal law that permitted national banks to engage in insurance agency activities. In reaching its conclusion, the Court explained that the history of the National Bank Act “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.”

However, the Supreme Court also has recognized that many types of state commercial and infrastructure laws do apply to national banks. The Supreme Court, only five years after the enactment of the National Bank Act, recognized that national banks may be subject to some state laws in the normal course of business if there is no conflict with Federal law.⁹ In holding that national banks’ contracts, their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are based on state law, the Court noted that national banks “are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation.”¹⁰ The OCC does not dispute this basic proposition.

The courts have continued to recognize that national banks are subject to state laws, unless those laws infringe upon the national banking laws or impose an undue burden on the performance of the banks’ federally authorized activities. In *McClellan v. Chipman*,¹¹ the Supreme Court held that the application to national banks of a state statute forbidding certain real estate transfers by insolvent transferees was not preempted as the statute would not impede or hamper national banks’ functions. In *Wichita Royalty Co. v. City Nat. Bank of Wichita Falls*,¹² the Court upheld the application of state tort law to a claim by a bank depositor against bank directors. And in *Anderson Nat. Bank v. Lueckett*,¹³ the Supreme Court held that a state statute administering abandoned deposit accounts did not unlawfully encroach on the rights and privileges of national banks and, as a result, was not preempted.

As these cases demonstrate, there are numerous state laws to which national banks remain subject because the laws do not significantly impede or interfere with powers granted national banks under federal law. Yet, in reaching this conclusion, these cases serve to confirm the fundamental principle of federal preemption as applied to national banks: that is, that the

⁶ 161 U.S. 275, 283 (1896).

⁷ 347 U.S. 373 (1954).

⁸ 517 U.S. 25, 32 (1996).

⁹ *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353 (1869).

¹⁰ *Id.* at 362 (1869).

¹¹ 164 U.S. 347 (1896).

¹² 306 U.S. 103 (1939).

¹³ 321 U.S. 233 (1944).

banking business of national banks is governed by federal standards. These uniform national standards and the federal supervision under which national banks operate are the defining attributes of the national bank component of our dual banking system.

II. State Fair Lending Laws

The OCC does not take the position that state laws prohibiting discrimination in lending (e.g., laws that prohibit lenders from discriminating on the basis of race, religion, ethnicity, gender, sexual orientation, disability, or the like) are preempted. This position was explained in a letter dated March 9, 2004, from then-Comptroller John D. Hawke, Jr., to the Honorable Barney Frank.¹⁴ Reflecting this, the OCC did not challenge the applicability to national banks of the New York state fair lending law underlying the Supreme Court's decision in *Cuomo v. Clearing House Ass'n, L.L.C.*¹⁵

In *Cuomo*, the OCC acknowledged that the state fair lending law was not preempted but challenged the state attorney general's authority to enforce it against national banks on the grounds that the National Bank Act¹⁶ prohibits the exercise of visitatorial authority except by the OCC or under other circumstances authorized by federal law.¹⁷ The Supreme Court held that a State attorney general could enforce non-preempted State law by bringing an action in court to enforce the non-preempted state law, but that the type of administrative investigation initiated by the state attorney general in this case was precluded by the National Bank Act.

There may be some misunderstanding of the OCC's position with regard to state fair lending laws, because some state laws imposing restrictions on mortgage lending terms have "fair lending" in their titles, but do not actually address unlawful discrimination in lending. For example, the Georgia Fair Lending Act ("GFLA")¹⁸ does not address lending discrimination but rather prohibits certain mortgage loan products and terms and imposes special restrictions when other loan terms or conditions are set. For this reason, the OCC concluded that various provisions of the GFLA were preempted.¹⁹

III. State Mortgage Lending Laws

The OCC's preemption rule issued in 2004 identifies and lists categories of state laws that ordinarily are, and are not, preempted.²⁰ The lists were drawn from existing case law and

¹⁴ OCC Interpretive Letter No. 998 (March 9, 2004).

¹⁵ 129 S. Ct. 2710 (June 29, 2009).

¹⁶ 12 U.S.C. § 484.

¹⁷ The *Cuomo* case concerned the OCC's visitatorial powers rule rather than the OCC's preemption rule. As we explained in our brief, the visitatorial powers "regulation does not declare the preemptive scope of the [National Bank Act], but identifies the circumstances under which state officials may act to enforce *non-preempted* state-law provisions." Brief for the Federal Respondent at 9 (filed March 25, 2009) (emphasis added).

¹⁸ Ga. Code Ann. §§ 7-6A-1 *et seq.*

¹⁹ 68 Fed. Reg. 46264 (Aug. 5, 2003).

²⁰ 69 Fed. Reg. 1904 (Jan. 13, 2004) (amending the OCC's real estate lending rules at 12 C.F.R. Part 34). In addition to real estate lending, the preemption rule also addressed deposit-taking, non-real estate lending, and, generally, activities authorized to national banks by Federal law. *Id.*

interpretations and are based on the preemption standards summarized in Barnett and developed by the Supreme Court.

The rule affects state law restrictions on mortgage lending terms and conditions in several respects. Examples of preempted laws include laws that restrict or prescribe the terms of credit, amortization schedules, permissible security property, permissible rates of interest, escrow accounts, disclosure and advertising, and laws that require a state license as a condition of national banks' ability to make loans.²¹

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

The OCC also included in the preemption rule two new provisions to ensure that the federal standards under which national banks operate directly address abusive or predatory lending practices. First, the preemption rule prohibits national banks from making a real estate loan (or other consumer loan) based predominantly on the foreclosure or liquidation value of a borrower's collateral, rather than on the borrower's ability to repay the loan according to its terms. This underwriting standard applies uniformly to all consumer lending activities of national banks, regardless of the location from which the bank conducts those activities or where their customers live. It is comprehensive, it is nationwide, and it targets lending practices, such as relying on future house price appreciation as the primary source of repayment that contributed significantly to the mortgage meltdown that sparked the financial crisis.

Second, the preemption rule provides that national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act in connection with any type of lending. Section 5 prohibits "unfair or deceptive acts or practices" in interstate commerce. This addition to our rule is particularly appropriate in light of the fact that the OCC pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct.²²

²¹ In *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007), the Supreme Court noted that the state licensing and registration requirements at issue in that case expressly exempted national banks from their application. As the Supreme Court explained, that exemption for national banks was "not simply a matter of the [state] legislature's grace. . . . For, as the parties recognize, the [National Bank Act] would have preemptive force, i.e., it would spare a national bank from state controls of the kind here involved."

²² The OCC's pioneering commitment to using the FTC Act to address consumer abuses is demonstrated by a number of actions against national banks that have resulted in the payment of hundreds of millions of dollars in restitution to consumers. For example, in 2000, the OCC required Provident National Bank to set aside not less than \$300 million for restitution to affected consumers; in 2005, the OCC required The Laredo National Bank and its subsidiary, Homeowners Loan Corporation, to set aside at least \$14 million for restitution to affected customers; and in 2008, the OCC required Wachovia Bank, N.A., to set aside \$125 million for restitution to affected consumers.

LISTING OF ATTACHMENTS TO APPENDIX A

69 Fed. Reg. 1904 (Jan. 13, 2004) (amending the OCC's real estate lending rules at 12 C.F.R. Part 34 to clarify the extent to which state laws in general apply to national banks' real-estate lending activities).

Remarks by John C. Dugan, Comptroller of the Currency, before the Women in Housing and Finance ("The Need to Preserve Uniform National Standards for National Banks"), Washington, DC (September 24, 2009).

OCC White Paper, "The Importance of Preserving A System of National Standards For National Banks" (October 2009).

enforce/enf_search.htm. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, in an action brought by Arizona against a national bank, among others, the restitution and remedial action ordered by the OCC in that matter against the bank was “comprehensive and significantly broader in scope than that available through [the] state court proceedings.” *State of Arizona v. Hispanic Air Conditioning and Heating, Inc.*, CV 2000–003625, Ruling at 27, Conclusions of Law, paragraph 50 (Aug. 25, 2003). Thus, the OCC has ample legal authority and resources to ensure that consumers are adequately protected.

List of Subjects in 12 CFR Part 7

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

Authority and Issuance

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

PART 7—BANK ACTIVITIES AND OPERATIONS

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

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

Subpart D—Preemption

■ 2. In § 7.4000:

- a. Add a new paragraph (a)(3); and
- b. Revise paragraph (b) to read as follows:

§ 7.4000 Visitorial powers.

(a) * * *

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

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

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

(i) Inspect the list of shareholders, provided that the official is authorized to assess taxes under state authority (12 U.S.C. 62; this section also authorizes inspection of the shareholder list by

shareholders and creditors of a national bank);

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

(iii) Verify payroll records for unemployment compensation purposes (26 U.S.C. 3305(c));

(iv) Ascertain the correctness of Federal tax returns (26 U.S.C. 7602);

(v) Enforce the Fair Labor Standards Act (29 U.S.C. 211); and

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

(2) *Exception for courts of justice.*

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

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

* * * * *

John D. Hawke, Jr.,

Comptroller of the Currency.

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 7 and 34

[Docket No. 04–04]

RIN 1557–AC73

Bank Activities and Operations; Real Estate Lending and Appraisals

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

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is publishing a final rule amending parts 7 and 34 of our regulations to add provisions

clarifying the applicability of state law to national banks’ operations. The provisions concerning preemption identify types of state laws that are preempted, as well as the types of state laws that generally are not preempted, with respect to national banks’ lending, deposit-taking, and other operations. In tandem with these preemption provisions, we are also adopting supplemental anti-predatory lending standards governing national banks’ lending activities.

EFFECTIVE DATE: February 12, 2004.

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

SUPPLEMENTARY INFORMATION:

I. Introduction

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

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

The provisions concerning preemption of state laws are contained in 12 CFR part 34, which governs national banks’ real estate lending, and in three new sections to part 7 added by this final rule: § 7.4007 regarding deposit-taking activities; § 7.4008 regarding non-real estate lending

¹ 15 U.S.C. 45(a)(1).

activities; and § 7.4009 regarding the other Federally-authorized activities of national banks. The first anti-predatory lending standard appears both in part 34, where it applies with respect to real estate consumer lending, and in part 7, with respect to other consumer lending. The provision prohibiting a national bank from engaging in unfair or deceptive practices within the meaning of section 5 of the FTC Act and regulations promulgated thereunder² similarly appears in both parts 34 and 7.

II. Description of Proposal

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

A. Proposed Revisions to Part 34—Real Estate Lending

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

Pursuant to our authority under 12 U.S.C. 93a and 371, we proposed to amend § 34.4(a) and (b) to provide a more extensive enumeration of the types of state law restrictions and requirements that do, and do not, apply

to the real estate lending activities of national banks. To the five types of state laws already listed in the regulations, proposed § 34.4(a) added a fuller, but non-exhaustive, list of the types of state laws that are preempted, many of which have already been found to be preempted by the Federal courts or OCC opinions. As also explained in the preamble to the NPRM, consistent with the applicable Federal judicial precedent, other types of state laws that wholly or partially obstruct the ability of national banks to fully exercise their real estate lending powers might be identified and, if so, preemption of those laws would be addressed by the OCC on a case-by-case basis.

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

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

The proposal retained the general rule stated in § 34.3 that national banks may “make, arrange, purchase, or sell loans or extensions of credit, or interests

therein, that are secured by liens on, or interests in, real estate, subject to terms, conditions, and limitations prescribed by the Comptroller of the Currency by regulation or order.” That provision was unchanged, other than by designating it as paragraph (a).

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

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

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

⁸ 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). These documents are available on the OCC’s Web site at <http://www.occ.treas.gov/advlst03.htm>.

⁹ 15 U.S.C. 45(a)(1).

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

⁴ 12 CFR 560.2.

⁵ 15 U.S.C. 1601 *et seq.*

⁶ 15 U.S.C. 1691 *et seq.*

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

² 12 CFR part 227.

³ Prior 12 CFR 34.1(b) and 34.4(a).

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

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

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

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

specifically addresses the applicability of state law. Finally, the proposal listed several types of state laws that, as a general matter, are not preempted.

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

III. Overview of Comments

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

Realtors. The vast majority—approximately 85%—of the opposing comments came from realtors and others representing the real estate industry, who expressed identical concerns about the possibility that national banks' *financial subsidiaries* would be permitted to engage in real estate brokerage activities¹¹ and that, if that power were authorized, the proposal would permit them to do so without complying with state real estate brokerage licensing laws. This final rule will not have that result because it does not apply to the activities of national bank financial subsidiaries. Thus, should the Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Board) proposal to permit financial subsidiaries and financial holding companies to engage in real estate brokerage activities go forward, this final rule would not affect the application of state real estate licensing requirements to national bank financial subsidiaries.

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

Community and consumer advocates. In addition to the comments from realtors, the OCC received opposing comments from community and consumer advocates. These commenters argued that the OCC should not adopt further regulations preempting state law and, in particular, should not adopt in

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

the final rule an “occupation of the field” preemption standard for national banks' real estate lending activities. The community and consumer advocates also asserted that the proposed “obstruct, in whole or in part” preemption standard is inconsistent with, and a lowering of, the preemption standards articulated by the U.S. Supreme Court. Whatever the standard, the community and consumer advocates expressed concern that preemption would allow national banks to escape some state tort, contract, debt collection, zoning, property transfer, and criminal laws, and would expose consumers to wide-spread predatory and abusive practices by national banks. These commenters asserted that the OCC's proposed anti-predatory lending standard is insufficient and urged the OCC to further strengthen consumer protections in parts 7 and 34, including prohibiting specific practices characterized as unfair or deceptive. These issues are addressed in sections IV and VI of this preamble.

State officials and members of Congress. State banking regulators, the Conference of State Bank Supervisors (CSBS), the National Conference of State Legislators, individual state legislators, the National Association of Attorneys General (NAAG), and individual state attorneys general questioned the legal basis of the proposal and argued that the OCC lacks authority to adopt it. These commenters, like the community and consumer advocates, also challenged the OCC's authority to adopt in the final rule either a “field occupation” preemption standard or the proposed “obstruct, in whole or in part” standard. These commenters raised concerns about the effect of the proposal, if adopted, on the dual banking system, and its impact on what they assert is the states' authority to apply and enforce consumer protection laws against national banks, and particularly against operating subsidiaries. Several members of Congress submitted comments, or forwarded letters from constituents and state officials, that echoed these concerns. The arguments concerning the dual banking system are addressed in the discussion of Executive Order 13132 later in this preamble.¹² The remaining issues raised by the state commenters are addressed in sections IV and VI of this preamble.¹³

¹² See also OCC publication entitled *National Banks and the Dual Banking System* (Sept. 2003).

¹³ See also Letter from John D. Hawke, Jr., Comptroller of the Currency, to Senator Paul S. Sarbanes (Dec. 9, 2003), available on the OCC's Web site at <http://www.occ.treas.gov/foia/SarbanesPreemptionletter.pdf>; and identical letters sent to nine other Senators; and Letters from John

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

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

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

IV. Reason and Authority for the Regulations

A. The Regulations Are Issued in Furtherance of the OCC’s Responsibility To Ensure That the National Banking System Is Able To Operate As Authorized by Congress

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

Federal law is the exclusive source of all of national banks’ powers and authorities. Key to these powers is the clause set forth at 12 U.S.C. 24(Seventh) that permits national banks to exercise “all such incidental powers as shall be necessary to carry on the business of banking.” This flexible grant of authority furthers Congress’s long-range goals in establishing the national banking system, including financing commerce, establishing private depositories, and generally supporting economic growth and development nationwide.¹⁷ The achievement of these goals required national banks that are safe and sound and whose powers are dynamic and capable of evolving so that they can perform their intended roles. The broad grant of authority provided by 12 U.S.C. 24(Seventh), as well as the more targeted grants of authority provided by other statutes,¹⁸ enable national banks to evolve their operations in order to meet the changing needs of our economy and individual consumers.¹⁹

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

¹⁸ See, e.g., 12 U.S.C. 92a (authorizing national banks to engage in fiduciary activities) and 371 (authorizing national banks to engage in real estate lending activities).

¹⁹ The Supreme Court expressly affirmed the dynamic, evolutionary character of national bank powers in *VALIC*, in which it held that the

The OCC is charged with the fundamental responsibility of ensuring that national banks operate on a safe and sound basis, and that they are able to do so, if they choose, to the full extent of their powers under Federal law. This responsibility includes enabling the national banking system to operate as authorized by Congress, consistent with the essential character of a national banking system and without undue confinement of their powers. Federal law gives the OCC broad rulemaking authority in order to fulfill these responsibilities. Under 12 U.S.C. 93a, the OCC is authorized “to prescribe rules and regulations to carry out the responsibilities of the office”²⁰ and, under 12 U.S.C. 371, to “prescribe by regulation or order” the “restrictions and requirements” on national banks’ real estate lending power without state-imposed conditions.²¹

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

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

Changes in applicable law also have contributed to the expansion of markets for national banks and their operating subsidiaries. These changes have affected both the type of products that may be offered and the geographic region in which banks—large and small—may conduct business. As a result of these changes, banks may branch across state lines and offer a broader array of products than ever before. An even wider range of

“business of banking” is not limited to the powers enumerated in 12 U.S.C. 24(Seventh) and that the OCC has the discretion to authorize activities beyond those specifically enumerated in the statute. See 513 U.S. at 258 n.2.

²⁰ 12 U.S.C. 93a.

²¹ 12 U.S.C. 371(a).

D. Hawke, Jr., Comptroller of the Currency, to Representatives Sue Kelly, Peter King, Carolyn B. Maloney, and Carolyn McCarthy (Dec. 23, 2003).

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

¹⁵ See, e.g., 12 U.S.C. 93a.

¹⁶ 68 FR 46119, 46120.

customers can be reached through the use of technology, including the Internet. Community national banks, as well as the largest national banks, use new technologies to expand their reach and service to customers.

Our modern society is also highly mobile. Forty million Americans move annually, according to a recent Congressional report issued in connection with enactment of the Fair and Accurate Credit Transactions Act of 2003.²² And when they move, they often have the desire, if not the expectation, that the financial relationships and status they have established will be portable and will remain consistent.

These developments highlight the significance of being able to conduct a banking business pursuant to consistent, national standards, regardless of the location of a customer when he or she first becomes a bank customer or the location to which the customer may move *after* becoming a bank customer. They also accentuate the costs and interference that diverse and potentially conflicting state and local laws have on the ability of national banks to operate under the powers of their Federal charter. For national banks, moreover, the ability to operate under uniform standards of operation and supervision is fundamental to the character of their national charter.²³ When national banks are unable to operate under national standards, it also implicates the role and responsibilities of the OCC.

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

Commenters noted that the variety of state and local laws that have been enacted in recent years—including laws regulating fees, disclosures, conditions on lending, and licensing—have created higher costs and increased operational

challenges.²⁴ Other commenters noted the proliferation of state and local anti-predatory lending laws and the impact that those laws are having on lending in the affected jurisdictions. As a result, national banks must either absorb the costs, pass the costs on to consumers, or eliminate various products from jurisdictions where the costs are prohibitive. Commenters noted that this result is reached even in situations where a bank concludes that a law is preempted, simply so that the bank may avoid litigation costs or anticipated reputational injury.

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

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

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, which negatively affects their

safety and soundness. The application of multiple, often unpredictable, different state or local restrictions and requirements prevents them from operating in the manner authorized under Federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential exposure. In some cases, this deters them from making certain products available in certain jurisdictions.²⁶

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

B. Pursuant to 12 U.S.C. 93a and 371, the OCC May Adopt Regulations That Preempt State Law

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

Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office * * *.²⁷

This language is significantly broader than that customarily used to convey rulemaking authority to an agency, which is typically focused on a particular statute. This was recognized, some 20 years ago, by the United States Court of Appeals for the D.C. Circuit in

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

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

²⁴ Illustrative of comments along these lines were those of banks who noted that various state laws would result in the following costs: (a) Approximately \$44 million in start-up costs incurred by 6 banks as a result of a recently-enacted California law mandating a minimum payment warning; (b) 250 programming days required to change one of several computer systems that needed to be changed to comply with anti-predatory lending laws enacted in three states and the District of Columbia; and (c) \$7.1 million in costs a bank would incur as a result of complying with mandated annual statements to credit card customers.

²⁵ See 68 FR 46264 (Aug. 5, 2003).

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

²⁷ 12 U.S.C. 93a.

its decision confirming that 12 U.S.C. 93a authorizes the OCC to issue regulations preempting state law. In *Conference of State Bank Supervisors v. Conover*,²⁸ the Conference of State Bank Supervisors (CSBS) sought to overturn a district court decision upholding OCC regulations that provided flexibility regarding the terms on which national banks may make or purchase adjustable rate mortgages (ARMs) and that preempted inconsistent state laws. The regulations provided generally that national banks may make or purchase ARMs without regard to state law limitations. The district court granted the OCC's motion for summary judgment on the ground that the regulations were within the scope of the OCC's rulemaking powers granted by Congress.

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

The Court of Appeals rejected the CSBS's contentions concerning the proper interpretation of 12 U.S.C. 93a. The Court of Appeals explained first that the challenged regulations (like this final rule) did not confer any new powers on national banks. Moreover, [t]hat the Comptroller also saw fit to preempt those state laws that conflict with his responsibility to ensure the safety and soundness of the national banking system, see 12 U.S.C. § 481, does not constitute an expansion of the powers of national banks.³⁰

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

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

The court summarized its rationale for holding that 12 U.S.C. 93a authorized

the OCC to issue the challenged regulations by saying:

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

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

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

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

The language and history of 12 U.S.C. 371 confirm the real estate lending powers of national banks and that only the OCC "subject to other applicable Federal law "and not the states may impose restrictions or requirements on national banks' exercise of those powers. The Federal powers conferred by 12 U.S.C. 371 are subject *only* "to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."³⁵

³² *Id.* at 878 (emphasis added).

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

³⁴ 12 U.S.C. 371(a).

³⁵ *Id.* As noted *supra* at note 7, Federal legislation occasionally provides that national banks shall conduct certain activities subject to state law

Thus, the exercise of the powers granted by 12 U.S.C. 371 is not conditioned on compliance with any state requirement, and state laws that attempt to confine or restrain national banks' real estate lending activities are inconsistent with national banks' real estate lending powers under 12 U.S.C. 371.

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

In 1982, Congress removed these "rigid statutory limitations"³⁸ in favor of a broad provision that is very similar to the current law and that authorized national banks to "make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation."³⁹ The purpose of the 1982 amendment was "to provide national banks with the ability to engage in more creative and flexible financing, and to become stronger participants in the home financing market."⁴⁰ In 1991, Congress removed the term "rule" from this phrase and enacted an additional requirement, codified at 12 U.S.C.

standards. For example, national banks conduct insurance sales, solicitation, and cross-marketing activities subject to certain types of state restrictions expressly set out in the Gramm-Leach-Bliley Act. See 15 U.S.C. 6701(d)(2)(B). There is no similar Federal legislation subjecting national banks' real estate lending activities to state law standards.

³⁶ Federal Reserve Act, Dec. 23, 1913, ch. 6, 38 Stat. 251, as amended.

³⁷ *Id.* section 24, 38 Stat. 273.

³⁸ S. Rep. No. 97-536, at 27 (1982).

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

⁴⁰ S. Rep. No. 97-536, at 27 (1982).

²⁸ 710 F.2d 878 (D.C. Cir. 1983).

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

³⁰ *Id.* (emphasis in original).

³¹ *Id.*

1828(o), that national banks (and other insured depository institutions) conduct real estate lending pursuant to uniform standards adopted at the Federal level by regulation of the OCC and the other Federal banking agencies.⁴¹

Thus, the history of national banks' real estate lending activities under 12 U.S.C. 371 is one of extensive Congressional involvement gradually giving way to a streamlined approach in which Congress has delegated broad rulemaking authority to the Comptroller. The two versions of 12 U.S.C. 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.

C. The Preemption Standard Applied in This Final Rule Is Entirely Consistent With the Standards Articulated by the Supreme Court

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

In *Barnett Bank of Marion County v. Nelson*,⁴⁷ the Supreme Court articulated preemption standards used by the

Supreme Court in the national bank context to determine, under the Supremacy Clause of the U.S. Constitution, whether Federal law conflicts with state law such that the state law is preempted. As observed by the Supreme Court in *Barnett*, a state law will be preempted if it conflicts with the exercise of a national bank's Federally authorized powers.

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

In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers. See, e.g., *Anderson Nat. Bank v. Lockett*, 321 U.S. 233, 247–252 (1944) (state statute administering abandoned deposit accounts did not “unlawful[ly] encroac[h] on the rights and privileges of national banks”); *McClellan v. Chipman*, 164 U.S. 347, 358 (1896) (application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not “destro[y] or hampe[r]” national banks' functions); *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869) (national banks subject to state law that does not “interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the Federal Government]”).⁴⁸

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

There is not—and from the very nature of the problem there cannot be—any rigid formula or rule which can be used as a universal pattern to determine the meaning and purpose of every act of Congress. This Court, in considering the validity of state laws in the light of

treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference. *But none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula.* Our primary function is to determine whether, under the circumstances of this particular case, [the state law at issue] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.⁵⁰

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

We have adopted in this final rule a statement of preemption principles that is consistent with the various formulations noted earlier. The phrasing used in the final rule—obstruct,⁵¹ impair,⁵² or condition⁵³—differs somewhat from what we proposed. This standard conveys the same substantive point as the proposed standard, however; that is, that state laws do not apply to national banks if they impermissibly contain a bank's exercise of a federally authorized power. The words of the final rule, which are drawn directly from applicable Supreme Court precedents, better convey the range of effects on national bank powers that the Court has found to be impermissible. The OCC intends this phrase as the distillation of the various preemption constructs articulated by the Supreme Court, as recognized in *Hines* and *Barnett*, and not as a replacement construct that is in any way inconsistent with those standards.

In describing the proposal, we invited comment on whether it would be appropriate to assert occupation of the entire field of real estate lending. Some commenters strongly urged that we do so, and that we go beyond real estate lending to cover other lending and deposit-taking activities as well. Upon further consideration of this issue and

⁴¹ 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 12 CFR part 34.

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

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

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

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

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

⁴⁷ 517 U.S. 25 (1996).

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

⁴⁹ 312 U.S. 52 (1941).

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

⁵¹ See *Hines*, 312 U.S. at 76.

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

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

careful review of comments submitted pertaining to this point, we have concluded, as the Supreme Court recognized in *Hines* and reaffirmed in *Barnett*, that the effect of labeling of this nature is largely immaterial in the present circumstances. Thus, we decline to adopt the suggestion of these commenters that we declare that these regulations “occupy the field” of national banks’ real estate lending, other lending, and deposit-taking activities. We rely on our authority under both 12 U.S.C. 93a and 371, and to the extent that an issue arises concerning the application of a state law not specifically addressed in the final regulation, we retain the ability to address those questions through interpretation of the regulation, issuance of orders pursuant to our authority under 12 U.S.C. 371, or, if warranted by the significance of the issue, by rulemaking to amend the regulation.

V. Description of the Final Rule

A. Amendments to Part 34

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

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

We have revised the anti-predatory lending standard in the final rule to clarify that it applies to consumer loans only, (*i.e.*, loans for personal, family, or household purposes), and to clarify that it is intended to prevent borrowers from being unwittingly placed in a situation where repayment is unlikely without the lender seizing the collateral. Where

the bargain agreed to by a borrower and a lender involves an understanding by the borrower that it is likely or expected that the collateral will be used to repay the debt, such as with a reverse mortgage, it clearly is not objectionable that the collateral will then be used in such a manner. Moreover, the final rule’s anti-predatory lending standard is not intended to apply to business lending or to situations where a borrower’s net worth would support the loan under customary underwriting standards.

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

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

3. *State laws that are preempted* (§ 34.4(a)). Pursuant to 12 U.S.C. 93a and 371, the final rule amends § 34.4(a) to add to the existing regulatory list of types of state law restrictions and requirements that are not applicable to national banks. This list, promulgated under our authority “to prescribe rules and regulations to carry out the responsibilities of the office” and to

prescribe the types of restrictions and requirements to which national banks’ real estate lending activities shall be subject, reflects our experience with types of state laws that can materially affect and confine—and thus are inconsistent with—the exercise of national banks’ real estate lending powers.⁵⁶

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

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

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

4. *State laws that are not preempted* (§ 34.4(b)). Section 34.4(b) also provides that certain types of state laws are not preempted and would apply to national banks to the extent that they are consistent with national banks’ Federal authority to engage in real estate lending because their effect on the real estate

⁵⁴ 15 U.S.C. 45(a)(1).

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

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

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

lending operations of national banks is only incidental. These types of laws generally pertain to contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, torts,⁵⁸ and homestead rights. In addition, any other law the effect of which is incidental to national banks' lending authority or otherwise consistent with national banks' authority to engage in real estate lending would not be preempted.⁵⁹ In general, these would be laws that do not attempt to regulate the manner or content of national banks' real estate lending, but that instead form the legal infrastructure that makes it practicable to exercise a permissible Federal power.

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

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

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

For § 7.4007, the final rule first sets out a statement of the authority to engage in the activity. Second, the final

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

For § 7.4008, the final rule also sets out a statement of the authority to engage in the activity (non-real estate lending), notes that state laws that obstruct, impair, or condition a national bank's ability to fully exercise this power are not applicable, and lists several types of state laws that are, or are not, preempted. Section 7.4008 also includes a safety and soundness-based anti-predatory lending standard. Final § 7.4008(b) states that "[a] national bank shall not make a consumer loan subject to this § 7.4008 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors." Separately, § 7.4008(c) also includes a statement that a national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the FTC Act and regulations promulgated thereunder in connection with making non-real estate related loans. The standards set forth in § 7.4008(b) and (c), plus an array of Federal consumer protection standards,⁶¹ ensure that national banks are subject to consistent and uniform Federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate

safety and soundness-based criteria for their lending activities.

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

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

As explained previously, in some circumstances, of course, Federal law directs the application of state standards to a national bank. The wording of § 7.4009 reflects that a Federal statute may require the application of state

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

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

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

⁶¹ See *supra* note 10.

⁶² As noted in the proposal, the OTS has issued a regulation providing generally that state laws purporting to address the operations of Federal savings associations are preempted. See 12 CFR 545.2. The extent of Federal regulation and supervision of Federal savings associations under the Home Owners' Loan Act is substantially the same as for national banks under the national banking laws, a fact that warrants similar conclusions about the applicability of state laws to the conduct of the Federally authorized activities of both types of entities. Compare, e.g., 12 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), 12 U.S.C. 481 (OCC authority to examine national banks and their affiliates), 12 U.S.C. 484 (OCC's exclusive visitatorial authority), and 12 U.S.C. 93a (OCC authority to issue regulations).

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

law,⁶⁴ or it may incorporate—or “Federalize”—state standards.⁶⁵ In those circumstances, the state standard obviously applies. State law may also apply if it only incidentally affects a national bank’s Federally authorized powers or if it is otherwise consistent with national banks’ uniquely Federal status. Like the other provisions of this final rule, § 7.4009 recognizes the potential applicability of state law in these circumstances. This approach is consistent with the Supreme Court’s observation that national banks “are governed in their daily course of business far more by the laws of the state than of the nation.”⁶⁶ However, as noted previously, these types of laws typically do not regulate the manner or content of the business of banking authorized for national banks, but rather establish the legal infrastructure that makes practicable the conduct of that business.

C. Application of Amendments to Operating Subsidiaries

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

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

The OCC shares the view of the commenters that predatory and abusive lending practices are inconsistent with national objectives of encouraging home ownership and community revitalization, and can be devastating to individuals, families, and communities.

⁶⁴ 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).

⁶⁵ See, e.g., 12 U.S.C. 92a (permissible fiduciary activities for national banks determined by reference to state law).

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

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

We will not tolerate such practices by national banks and their operating subsidiaries. Our Advisory Letters on predatory lending,⁶⁸ our pioneering enforcement positions resulting in substantial restitution to affected consumers, and the anti-predatory lending standards adopted in this final rule reflect our commitment that national banks operate pursuant to high standards of integrity in all respects. The provisions of this final rule, clarifying that certain state laws are not applicable to national banks’ operations, do not undermine the application of these standards to all national banks, for the protection of all national bank customers—wherever they are located.

Advisory Letters 2003–2, which addresses loan originations, and 2003–3, which addresses loan purchases and the use of third party loan brokers, contain the most comprehensive supervisory standards ever published by any Federal financial regulatory agency to address predatory and abusive lending practices and detail steps for national banks to take to ensure that they do not engage in such practices. As explained in the Advisory Letters, if the OCC has evidence that a national bank has engaged in abusive lending practices, we will review those practices not only to determine whether they violate specific provisions of law such as the Homeowners Equity Protection Act of 1994 (HOEPA), the Fair Housing Act, or the Equal Credit Opportunity Act, but also to determine whether they involve unfair or deceptive practices that violate the FTC Act. Indeed, several practices that we identify as abusive in our Advisory Letters—such as equity stripping, loan flipping, and the refinancing of special subsidized mortgage loans that originally contained terms favorable to the borrower—generally can be found to be unfair or deceptive practices that violate the FTC Act.

Moreover, our enforcement record, including the OCC’s pioneering actions using the FTC Act to address consumer abuses that were not specifically prohibited by regulation, demonstrates our commitment to keeping abusive practices out of the national banking system. For example, *In the Matter of Providian Nat’l Bank, Tilton, New Hampshire*,⁶⁹ pursuant to the FTC Act, the OCC required payment by a national bank to consumers in excess of \$300 million and imposed numerous

conditions on the conduct of future business. Since the Providian settlement in 2000, the OCC has taken action under the FTC Act to address unfair or deceptive practices and consumer harm involving five other national banks.⁷⁰

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

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

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

⁷¹ See *In the Matter of Clear Lake National Bank, San Antonio, Texas*, Enforcement Action 2003–135 (Nov. 7, 2003), available at <http://www.occ.treas.gov/FTP/EAs/ea2003-135.pdf>. We believe these enforcement actions, which have generated hundreds of millions of dollars for consumers in restitution, also demonstrate that the OCC has the resources to enforce applicable laws. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, in an action brought by Arizona against a national bank, among others, the restitution and remedial action ordered by the OCC in that matter against the bank was “comprehensive and significantly broader in scope than that available through [the] state court proceedings.” *State of Arizona v. Hispanic Air Conditioning and Heating, Inc.*, CV 2000–003625, Ruling at 27, Conclusions of Law, paragraph 50 (Aug. 25, 2003).

⁷² See *In the Matter of Peoples National Bank, Paris, Texas*, Enforcement Action 2003–2; *In the Matter of First National Bank in Brookings, Brookings, South Dakota*, Enforcement Action 2003–1; *In the Matter of Goleta National Bank, Goleta, California*, Enforcement Action 2002–93; and *In the Matter of Eagle National Bank, Upper Darby, Pennsylvania*, Enforcement Action 2001–

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

Less than one year ago, nearly two dozen State Attorneys General signed a brief in litigation that reached the same conclusion. That case involved a revised regulation issued by the Office of Thrift Supervision to implement the Alternative Mortgage Transaction Parity Act (AMTPA). The revised regulation seeks to distinguish between Federally supervised thrift institutions and non-bank mortgage lenders and makes non-bank mortgage lenders subject to state law restrictions on prepayment penalties and late fees. In *supporting* the OTS's decision to retain preemption of state laws for supervised depository

institutions and their subsidiaries but *not* for unsupervised housing creditors, the State Attorneys General stated:

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

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

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

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

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

VII. Regulatory Analysis

CDRI Act Delayed Effective Date

This final rule takes effect 30 days after the date of its publication in the **Federal Register**, consistent with the delayed effective date requirement of the Administrative Procedure Act. *See*

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

Regulatory Flexibility Act

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

Executive Order 12866

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

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (2 U.S.C. 1532) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement

104. These orders can also be found on the OCC's Web site within the “Popular FOIA Requests” section at <http://www.occ.treas.gov/foia/foiadocs.htm>.

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

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

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

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

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

⁷⁵ *Id.* at 10.

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

before promulgating any rule likely to result in a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC has determined that this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of \$100 million or more in any one year. Accordingly, this rulemaking is not subject to section 202 of the Unfunded Mandates Act.

Executive Order 13132

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

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

Consultation. The Order requires that, to the extent practicable and permitted by law, no agency shall promulgate any

regulation that has Federalism implications and that preempts state law unless, prior to the formal promulgation of the regulation, the agency consults with state and local officials early in the process of developing the proposal. We have consulted with state and local officials on the issues addressed herein through the rulemaking process. Following the publication of the proposal, representatives from the Conference of State Bank Supervisors (CSBS) met with the OCC to clarify their understanding of the proposal and, subsequently, the CSBS submitted a detailed comment letter regarding the proposal. As mentioned previously, additional comments were also submitted on the proposal by other state and local officials and state banking regulators. Pursuant to the Order, we will make these comments available to the Director of the OMB. Subsequent, public statements by representatives of the CSBS have restated their concerns, and CSBS representatives have further discussed these concerns with the OCC on several additional occasions.

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

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

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

a. There is fundamental disagreement between state and local officials and the OCC regarding preemption in the national bank context. For the reasons set forth in the materials that precede this Federalism impact statement, we believe that this final rule is necessary to enable national banks to operate to the full extent of their powers under Federal law, and without interference from inconsistent state laws; consistent with the national character of the national banks; and in furtherance of their safe and sound operations. We also believe that this final rule has ample

support in statute and judicial precedent. The concerns of the state and local officials could only be fully met if the OCC were to take a position that is contrary to Federal law and judicial precedent. Nevertheless, to respond to some of the issues raised, the language in this final regulation has been refined, and this preamble further explains the standards used to determine when preemption occurs and the criteria for when state laws generally would *not* be preempted.

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

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

List of Subjects

12 CFR Part 7

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

12 CFR Part 34

Mortgages, National banks, Real estate appraisals, Real estate lending

standards, Reporting and recordkeeping requirements.

Authority and Issuance

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

PART 7—BANK ACTIVITIES AND OPERATIONS

■ 1. The authority citation for part 7 is revised to read as follows:

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

Subpart D—Preemption

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

§ 7.4007 Deposit-taking.

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

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

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

(i) Abandoned and dormant accounts;³

(ii) Checking accounts;

(iii) Disclosure requirements;

(iv) Funds availability;

(v) Savings account orders of withdrawal;

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

(vii) Special purpose savings services;⁴

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

- (1) Contracts;
- (2) Torts;
- (3) Criminal law;⁵
- (4) Rights to collect debts;
- (5) Acquisition and transfer of property;

- (6) Taxation;
- (7) Zoning; and

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

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

§ 7.4008 Lending.

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

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

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

(d) *Applicability of state law.* (1) Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's

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 offenses 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).

ability to fully exercise its Federally authorized non-real estate lending powers are not applicable to national banks.

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

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

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

(iii) Loan-to-value ratios;

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

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

(vi) Security property, including leaseholds;

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

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

(ix) Disbursements and repayments; and

(x) Rates of interest on loans.⁶

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

(1) Contracts;

(2) Torts;

(3) Criminal law;⁷

(4) Rights to collect debts;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and

⁶ 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; 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.

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

³ This does not apply to state laws of the type upheld by the United States Supreme Court in *Anderson Nat'l Bank v. Lockett*, 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.

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

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

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

§ 7.4009 Applicability of state law to national bank operations.

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

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

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

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

- (i) Contracts;
- (ii) Torts;
- (iii) Criminal law⁸
- (iv) Rights to collect debts;
- (v) Acquisition and transfer of property;
- (vi) Taxation;
- (vii) Zoning; and
- (viii) Any other law the effect of which the OCC determines to be incidental to the exercise of national bank powers or otherwise consistent with the powers set out in paragraph (a) of this section.

PART 34—REAL ESTATE LENDING AND APPRAISALS

Subpart A—General

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

Authority: 12 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 new

paragraphs (b) and (c) are added to read as follows:

§ 34.3 General rule.

* * * * *

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

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

■ 7. Section 34.4 is revised to read as follows:

§ 34.4 Applicability of state law.

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

- (1) Licensing, registration (except for purposes of service of process), filings, or reports by creditors;
- (2) The ability of a creditor to require or obtain private mortgage insurance, insurance for other collateral, or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices;
- (3) Loan-to-value ratios;
- (4) The terms of credit, including schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;
- (5) The aggregate amount of funds that may be loaned upon the security of real estate;
- (6) Escrow accounts, impound accounts, and similar accounts;
- (7) Security property, including leaseholds;

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

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

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

(11) Disbursements and repayments;

(12) Rates of interest on loans;¹

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

- (1) Contracts;
- (2) Torts;
- (3) Criminal law;²
- (4) Homestead laws specified in 12 U.S.C. 1462a(f);
- (5) Rights to collect debts;
- (6) Acquisition and transfer of real property;
- (7) Taxation;
- (8) Zoning; and
- (9) Any other law the effect of which the OCC determines to be incidental to the real estate lending operations of national banks or otherwise consistent with the powers and purposes set out in § 34.3(a).

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

- (9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;
- (10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;
- (11) Disbursements and repayments;
- (12) Rates of interest on loans;¹
- (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) State laws on the following subjects are not inconsistent with the real estate lending powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national banks' real estate lending powers:

- (1) Contracts;
- (2) Torts;
- (3) Criminal law;²
- (4) Homestead laws specified in 12 U.S.C. 1462a(f);
- (5) Rights to collect debts;
- (6) Acquisition and transfer of real property;
- (7) Taxation;
- (8) Zoning; and
- (9) Any other law the effect of which the OCC determines to be incidental to the real estate lending operations of national banks or otherwise consistent with the powers and purposes set out in § 34.3(a).

Dated: January 6, 2004.

John D. Hawke, Jr.,

Comptroller of the Currency.

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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).

⁸ *Id.*

Remarks by
John C. Dugan
Comptroller of the Currency
Before
Women in Housing and Finance
Washington, DC
September 24, 2009

**The Need to Preserve
Uniform National Standards for National Banks**

I welcome this opportunity for a return engagement before Women in Housing and Finance at this very critical time. We are, of course, in the middle of an important national debate about how best to address the gaps and weaknesses in financial regulation that were exposed by the financial events of the last two years. In this context, the Treasury Department's plan to strengthen our regulatory framework is both thoughtful and comprehensive, and I support many of its core elements.

Among these are certain parts of the plan that would enhance consumer protection. One is the establishment of a strong federal rulewriter – which Treasury proposes as a new Consumer Financial Protection Agency or “CFPA” – to issue uniform national rules for consumer protection. These rules would apply equally not just to federally regulated banks, but also – and this is critically important – to the literally hundreds of thousands of nonbank financial providers, such as finance companies and mortgage brokers, that have been unregulated or lightly regulated by the states. It is well established that this “shadow banking system” of unregulated financial providers has

been the source of the worst consumer protection and underwriting abuses, especially in the area of subprime mortgages.

For the same reason, I support providing the CFPA with supervisory and enforcement authority over these nonbank financial providers, which is crucial to ensure their compliance with CFPA rules to the same extent as banks. However, for reasons that have received a great deal of attention in congressional hearings and media accounts, I think the plan should not strip such authority from bank regulators, where I believe the current system has worked well.

Today I would like to focus my remarks on a different part of the consumer protection plan that has received less attention than I think it deserves, given its critical importance. That is the sweeping proposal to eliminate uniform national consumer protection standards by repealing key parts of the National Bank Act's preemption of state laws, which unfortunately I cannot support. This radical change is fundamentally at odds with the concept of efficient national standards for national products and services offered across state lines in national markets – a concept that has been central to the economic prosperity of the United States since the adoption of our Constitution, and one that has been critical to the flourishing of our national banking system since 1863. More importantly – and especially with the strong federal consumer protection rules envisioned by the new CFPA – truly uniform national standards that provide real benefits to consumers would be undermined by the repeal of national bank preemption.

Importance of National Standards in US History

Let me explain my strong concerns, beginning, if you will indulge me, with a brief history of the important role that national standards have played in our economic

history. After the Revolutionary War, the critical and well recognized weakness in the Articles of Confederation was that it permitted individual states to erect commercial barriers to trade with neighboring states and foreign powers.¹ The ensuing problems precipitated the adoption of our national Constitution in 1789, because the framers understood that fragmentation via differing state laws was incompatible with economic growth, efficiency, and innovation by the nation as a whole. Indeed, one of the most critical changes the Constitution made was to grant Congress plenary authority over commerce in Article I, Section 8. Aptly referred to as the “Interstate Commerce clause,” this provision empowered Congress to establish uniform national standards to govern economic activities that span state boundaries, clearing the way for the emergence of a truly national economy.²

How these principles should apply to banking, and whether the national interest was served by a federal role in the banking system, was one of the earliest policy debates addressed by the new government. Creation of the First Bank of the United States in 1791 and the Second Bank of the United States in 1816 substantially benefited the nation’s finances, but proved hugely controversial. Beyond attracting charges of excessive concentration of power, these federal banks were seen as threats to state-chartered institutions. Maryland’s attempt to prevent effective operation of the Second Bank through state taxation resulted in a landmark Supreme Court decision – *McCulloch v. Maryland* – that confirmed the national government’s power to establish a bank and the supremacy of federal over state law.

¹ For example, some states with ports exacted a price from producers in landlocked states to move goods to market; states adopted bankruptcy laws that advantaged local creditors and debtors at the expense of others; and states sought to tax and regulate the United States mails.

² “To regulate Commerce with foreign Nations, and among the Several States, and with the Indian Tribes[.]”

The controversy came to a head in 1836, when Andrew Jackson vetoed the renewal of the Second Bank. His principal political opponent, Henry Clay, articulated a very different vision, rooted in the ideas of Alexander Hamilton, of a truly American system based on national standards and institutions. Clay proposed to extend the life of the national bank, protect American industry, and establish a national network of roads and rails. And it was one of Clay's most enthusiastic followers, Abraham Lincoln, who was to ensure that Clay's national vision ultimately prevailed.

In 1861, the departure of secessionist legislators from Washington marked a critical step on the path to Civil War. But it also ushered in a period of unprecedented legislative productivity that advanced national economic goals. This included the construction of a transcontinental railroad, expansion of the national telegraph network, improvements in roads and canals, and of course, establishment of our national banking system through the National Currency Act of 1863 and the National Bank Act of 1864, which Lincoln helped shape into law.

In adopting these measures, Congress did not abolish state banking. But it did include explicit protections in the new framework so that national banks would be governed by federal standards administered by a new federal agency – the Office of the Comptroller of the Currency. The OCC has successfully carried out those duties for nearly 150 years, and over that same period, a series of Supreme Court decisions have confirmed the fundamental principle of federal preemption as applied to national banks: that is, that the banking activities of national banks are governed by national standards established by Congress, subject to supervision and oversight by the OCC.

With this design, the state and national banking systems have grown up around one another, creating the “dual banking system” we know today. Encompassing both large institutions that market products and services nationally and very small institutions that do business exclusively in their immediate communities, it is a diverse system with complex linkages and interdependencies. In this context and over time, a crucial benefit has been clear: the “national” part of the dual banking system, the part that has allowed large and small national banks to operate under uniform national rules across state lines, has strongly fostered the growth of national products and services in national and multi-state markets.

Repeal of National Bank Preemption

Returning to the Treasury plan, it’s important to recognize that key parts of it promote and endorse the concept of uniform national standards. Indeed, as previously discussed, one of its critical intended benefits is that strong federal rules issued by the new CFPA would apply equally to all financial providers, whether bank or nonbank. Another of its goals is to raise the level of compliance with such rules by nonbanks, which today are unregulated or very lightly regulated, to the same level as currently applies to federally regulated banks. Both of these aspects of the plan are fully consistent with the principle of uniform national standards, uniformly applied – as are other aspects of the plan.³

³ See, e.g., Proposal, *supra* note 1, at 69 (discussing the proposed CFPA, observing that “[f]airness, effective competition, and efficient markets require consistent regulatory treatment for similar products,” and noting that consistent regulation facilitates consumers’ comparison shopping); and at 39 (discussing the history of insurance regulation by the states, which “has led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers.”).

Unfortunately, however, the very principle of uniform national standards is expressly undermined by the plan's specific grant of authority to individual states to adopt different rules; by the repeal of uniform standards for national banks; and by the empowerment of individual states, with their very differing points of view, to enforce federal consumer protection rules – under all federal statutes – in ways that might vary from state to state. In effect, the resulting patchwork of federal-plus-differing-state standards would distort and displace the CFPA's federal rulemaking. This is true even though the CFPA's federal rules would be the product of an open public comment process and the behavioral research and evaluative functions that the plan highlights.

In particular, for the first time in the 146-year history of the national banking system, federally chartered banks would be subject to multiple state operating standards, because the plan would sweepingly repeal the ability of national banks to conduct retail banking business under uniform national standards. This rejection and reversal of such standards is an extreme change that is, in my view, both unwise and unjustified.

Given the CFPA's enhanced authority and mandate to write stronger consumer protection rules, and the thorough and expert processes described as integral to its rulemaking, there should no longer be any issue as to whether sufficiently strong federal consumer protection standards would be in place and apply to national banks. In this context there is no need to authorize states to adopt different standards for such banks. Likewise, there is no need to authorize states to enforce federal rules against national banks – which would inevitably result in differing state interpretations of federal rules – because federal regulators already have broad enforcement authority over such institutions and the resources to exercise that authority fully.

More fundamentally, we live in an era where the market for financial products and services is often national in scope. Advances in technology, including the Internet and the increased functionality of phones, enable banks to do business with customers in many states. Our population is increasingly mobile, and many people live in one state and work in another – as is true for many of us in the Washington, D.C. area.

In this context, regressing to a regulatory regime that fails to recognize the way retail financial services are now provided, and the need for a single set of rules for banks with customers in multiple states, would discard many of the benefits consumers reap from our modern financial product delivery system. Such a balkanized approach could give rise to significant uncertainty about which sets of standards apply to institutions conducting a multistate business. That in turn would generate major legal and compliance costs, and major impediments to interstate product delivery.

Moreover, this issue is very real for all banks operating across state lines – not just national banks. Recognizing the importance of preserving uniform interstate standards for all banks operating in multiple states, Congress expressly provided in the “Riegle-Neal II” Act enacted in 1997 that state banks operating through interstate branches in multiple states should enjoy the same federal preemption and ability to operate with uniform standards as national banks.⁴

Accordingly, repealing uniform national standards for national banks would create fundamental, practical problems for all banks operating across state lines, large or small. For example, there are a number of areas in which complying with different standards set by individual states would require a bank to determine which state’s law governs – the law of the state where a person provides a product or service; the law of the

⁴ 12 U.S.C. § 1831a(j); *see also id.* at 1831d (interest rates; parity for state banks).

home state of the bank; or the law of the state where the customer is located. It is far from clear how a bank could do this based on objective analysis, and any conflicts could result in penalties and litigation in multiple jurisdictions.

And think about some of the practical problems that could arise from different grace periods for credit cards; different internet advertising rules; different solicitation standards for telephone sales, with different duties for sales personnel; different employee compensation limits; and different licensing requirements for new products.

Or consider a more detailed example involving terms for a checking account. Today a bank can offer customers checking accounts with uniform terms and uniform disclosures through branches in multiple states, over the Internet, and through various forms of media. Under the plan, individual states could adopt particular required or prohibited terms for different aspects of these checking accounts, as well as additional disclosure and advertising requirements. For example, there could be state-by-state differences in rules on the number and amount of withdrawals or deposits, permissible minimum balance requirements, and ATM screen disclosures. States could assert that those requirements apply according to the law of the state in which the branch offering the account is located, the home state of the bank, the state where the customer resides, or someplace else. States could have different standards for exerting jurisdiction over the terms and disclosures, creating the potential for the laws of two or more states to apply to the same transaction. How would a bank advertise in the newspaper or on the radio to promote its checking accounts if it were located in a multistate region – such as the Washington D.C. area – if different states imposed different requirements regarding terms and disclosures? Even if the bank figured all this out for a particular customer, that

could all change if the customer moved, or if the bank merged with another bank located in a different state. Would that mean the customer would have to open a new account to incorporate the state's required terms? And even if Congress added language to address some of the questions we can think of today, there would only be more uncertainties tomorrow – and no realistic possibility of writing a fix into national law each time a new issue arose.

Such uncertainties have the real potential to confuse consumers, subject providers to major new liabilities, and significantly increase the cost of doing business in ways that will be passed on to consumers. It could also cause providers to pull back where increased costs erase an already thin profit margin – for example, with “indirect” auto lending across state lines – or where they see unacceptable levels of uncertainty and risk.

Moreover, a bank with multistate operations might well decide that the only sensible way to conduct a national business would be to operate to the most stringent standard prevailing in its most significant state market. It should not be the case that a decision by one state legislature about how products should be designed, marketed, or sold should effectively replace a national regulatory standard established by the federal government based on thorough research and an open and nationwide public comment process, as would be the case with the new CFPA.

Finally, subjecting national banks to state laws and state enforcement of federal laws is a potentially crippling change to the national bank charter and a rejection of core principles that form the bedrock of the dual banking system. For nearly 150 years, national banks have been subject to a uniform set of federal rules enforced by the OCC, and state banks have generally been subject to their own states' rules. This dual banking

system has worked well, as it has allowed a state to serve as a “laboratory” for new regulation – without compelling adoption of a particular regulation as a national standard.

That is, the dual banking system is built on individual states experimenting with different kinds of laws, including new consumer protection laws, that apply to a state’s own banks, but not to state banks in all states and not to national banks. Some of these individual state laws have proven to be good ideas, while others have not. When Congress has believed that a particular state’s experiment is worthwhile, it has enacted that approach to apply throughout the country, not only to national banks, but to state banks operating in other states that have not yet adopted such laws. As a result, national banks operate under an evolving set of federal rules that are at any one time the same, regardless of the state in which the banks are headquartered, or the number of different states in which they operate. This reliable set of uniform federal rules is a defining characteristic of the national bank charter. It has helped banks provide a broader range of products at lower cost, with savings that can be passed along to the consumer.

Preemption Has Not Harmed Consumers

In short, there are many good reasons to oppose the plan’s rejection of uniform national standards for national banks, especially given the strong rulewriting role envisioned for the CFPB. But are there good reasons for supporting this aspect of the proposal? I think not. The argument I’ve heard most often is that repealing national bank preemption is necessary to stop national banks from engaging in activities that caused the financial crisis, like predatory subprime lending, which critics say state consumer protection laws would have prevented.

That argument is just plain wrong. Its premise is that national banks were the source of predatory and unsafe mortgage loans, while state-regulated institutions were not. That's exactly backwards. It is widely recognized that the worst subprime loans that have caused the most foreclosures were originated by nonbank lenders and brokers regulated exclusively by the states. Although the OCC has little rulewriting authority in this area, we have closely supervised national bank subprime lending practices. As a result, national banks originated a relatively smaller share of subprime loans and applied better standards, resulting in significantly fewer foreclosures – as demonstrated in an attachment to this speech prepared last year by OCC staff. Meanwhile, nothing in federal law precluded states from effectively regulating their own nonbank mortgage lenders and brokers. Indeed, that's why the plan's grant of strong rulewriting and enforcement authority at the federal level over the shadow banking system of unregulated financial providers, through the CFPB, is such a good idea – and why granting the states new authority over national banks is not.

Another argument I hear focuses on enforcement, asserting that the new law should empower state officials to enforce consumer protection rules against national banks – including federal consumer protection rules issued by the new CFPB – because there supposedly can never be “too many cops on the beat.” But this assertion is simply not true in a world that has only a limited number of “cops.” State resources are finite, and there are hundreds of thousands of nonbank financial providers, including subprime lenders and brokers, that have been the disproportionate source of financial consumer protection problems. These are the firms most in need of supervisory and enforcement attention, by both the states and the new CFPB. That's where state enforcement

resources should be devoted, rather than diluting them on national banks that are already extensively supervised by the OCC. And if state officials have information that national banks appear to be violating applicable law or otherwise engaging in inappropriate practices, we want to hear about it, we will follow up on it, and we will be open with those officials about what we find and what we propose to do about it. All of us want consumers to be treated fairly and honestly; by collaborating rather than duplicating, we can better help achieve that result.

Conclusion

In sum, throughout our history, uniform national standards have proved to be a powerful engine for prosperity and growth. Such standards for national banks have been very much a part of this history, and have produced real benefits for consumers. As Congress moves forward with legislation on financial consumer protection, its goals should be to strengthen federal rules and apply them more uniformly to all providers of the same financial products – goals shared by the Treasury Plan. It should not be to undermine those goals by inviting every state to adopt its own rules for national banks – a course of action likely to produce far greater costs than benefits.

* * * *



Comptroller of the Currency
Administrator of National Banks

Washington, DC 2021

**The Importance of
Preserving a System of
National Standards
For
National Banks**

January 2010

The Importance of Preserving a System of National Standards for National Banks

I. Introduction

Since the establishment of the national banking system in 1863 and 1864, banks and their consumers have benefitted from the dynamic of the dual banking system. State banking systems can serve as laboratories of regulatory innovation, exploring new products and regulatory approaches to issues that, if successful, may be adopted at the federal level. The national banking system, operating under uniform federal standards across state lines, strongly fosters an open financial marketplace, the growth of national products and services in national and multi-state markets, and reduced costs.

The legal principle that supports uniform federal standards for national banks is the doctrine of federal “preemption,” which flows directly from the Supremacy Clause of the U.S. Constitution. The Supreme Court has long held that, under the doctrine of federal preemption, any state law that conflicts, impedes, or interferes with national banks’ federally-granted powers may not be applied to national banks – the state law is “preempted” by federal power. Preservation of the uniform federal standards has benefitted consumers of financial products by making a wider range of banking products and services available to more consumers and, overall, lowering the costs of credit and other banking products and services. In turn, the banking system benefits from greater economies of scale and improved risk management.

Critics of federal preemption have argued that it undermines the dual banking system. This argument, however, dismisses the clear benefits the system produces for consumers and banks alike, and shortchanges the state banking systems and the vital role they play in the dual banking system.

Other critics contend that federal preemption is contrary to consumers’ interests and assert that preemption was one of the leading causes of the subprime mortgage lending crisis. The facts

simply do not bear this out. National banks and their subsidiaries originated only 12 to 14 percent of all subprime mortgages between 2005 and 2007. The vast majority of the subprime mortgages originated during these years were made by state licensed and supervised entities. The limited role that national banks and their subsidiaries played in the subprime mortgage lending crises strongly suggests that federal preemption had little to do with the crisis. This conclusion is bolstered by the track record of performance of subprime loans originated by national banks, which is better than the performance of subprime lending done by nonbanks in recent years.

II. The National Banking System and Federal Preemption

Congress enacted the National Currency Act of 1863 and the National Bank Act of 1864 to establish a national banking system to operate distinctly and separately from the existing system of private state banks. In adopting these measures, Congress did not abolish state banking, but was concerned about state legislation hostile to banks that the states did not create and control. To shield the national banks from such legislation, Congress included explicit protections in the new framework to ensure that national banks would be governed by Federal standards administered exclusively by a new federal agency – the Office of the Comptroller of the Currency. With the establishment of the national banks, Congress created the “dual banking system,” in which both the states and the federal government have the power to charter banks and the power to supervise and regulate independently the banks they have chartered. The dual banking system remains in place today.

A. Doctrine of Federal Preemption Flows Directly from the Supremacy Clause of the United States Constitution

At the core of the national banking system is the principle that national banks, in carrying on the business of banking under a federal authorization, should be subject to uniform national

standards and uniform federal supervision.¹ The legal principle that produces such a result is the “preemption” of state law. The doctrine of preemption flows directly from the Supremacy Clause of the U.S. Constitution,² and provides that the Constitution and laws of the United States are the “Supreme Law” of the land, notwithstanding anything in the Constitution or laws of the States to the contrary. The Supremacy Clause was the basis for the landmark 1819 Supreme Court decision, *McCulloch v. Maryland*,³ which established the bedrock principle that state law cannot stand as an obstacle to the accomplishment of federal legislative goals.

B. For Over 140 Years, the Supreme Court Has Held That State Laws Which Conflict, Impede, or Interfere with National Banks’ Powers and Activities Are Preempted

In the years following the National Bank Act’s enactment, the Supreme Court 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 National Bank Act could develop and flourish. This point was highlighted by the Supreme Court in 1903 in *Easton v. Iowa*.⁴ The Court stressed that the application of multiple states’ standards would undermine the uniform, national character of the powers of national banks, which operate in –

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.... If [the states] 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.⁵

¹ In discussing the impact of the National Currency Act and National Bank Act, Senator Sumner stated that, “[c]learly, 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.” Cong. Globe, 38th Cong., 1st Sess., at 1893 (April 27, 1864).

² U.S. Constitution Article VI, cl. 2.

³ *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819).

⁴ 188 U.S. 220 (1903).

⁵ *Id.* at 229, 230-31. A similar point was made by the Court in *Talbott v. Bd. of County Commissioners of Silver Bow County*, in which the court stressed that the entire body of the Statute respecting national banks, emphasize that which the character of the system implies - an intent to create a national banking system co-extensive with the territorial limits of the United States, and with uniform operation within those limits. 139 U.S. 438, 443 (1891).

The Supreme Court strongly reaffirmed this point in 2007 in *Watters v. Wachovia*,⁶ stating:

Diverse and duplicative superintendence [by the states] of national banks' engagement in the business of banking, we observed over a century ago, is precisely what the [National Bank Act] was designed to prevent.⁷

The Supreme Court and lower federal courts have repeatedly made clear that state laws that conflict, impede, or interfere with national banks' powers and activities are preempted. For example, in *Davis v. Elmira Savings Bank*,⁸ the Supreme Court stated: "National banks are instrumentalities of the Federal Government, ... It follows that an attempt, by a state, to define their duties or control the conduct of their affairs, is absolutely void." In *Franklin National Bank v. New York*,⁹ the Supreme Court held that a state could not prohibit a national bank from using the word "savings" in its advertising, since the state law conflicts with the power of national banks to accept savings deposits. More recently, in *Barnett Bank v. Nelson*,¹⁰ the Supreme Court affirmed the preemptive effective of federal banking law under the Supremacy Clause and held that a state statute prohibiting banks from engaging in most insurance agency activities was preempted by Federal law that permitted national banks to engage in insurance agency activities. In reaching its conclusion, the Court explained that the history of the National Bank Act "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."

C. *However, the Supreme Court Also Has Recognized That Many Types of State Commercial and Infrastructure Laws Do Apply to National Banks*

The common thread running through these cases recited above is the preemption of a state law that impedes or interferes with national banks' powers. On the other hand, states are

⁶ 550 U.S. 1 (2007).

⁷ *Id.* at 14.

⁸ 161 U.S. 275, 283 (1896).

⁹ 347 U.S. 373 (1954).

¹⁰ 517 U.S. 25, 32 (1996).

permitted to regulate the activities of national banks where doing so does not impair, encroach upon, significantly interfere with, or prevent the exercise of these powers.¹¹ Thus, many types of state commercial and business “infrastructure” laws are not preempted, and national banks remain subject to significant state statutory schemes, including contracts, torts, criminal justice, zoning, right to collect debt, and many other generally applicable commercial and business standards. The OCC has recognized that such laws are not preempted.¹²

The Supreme Court, only five years after the enactment of the National Bank Act, recognized that national banks may be subject to some state laws in the normal course of business if there is no conflict with Federal law.¹³ In holding that national banks’ contracts, their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are based on State law, the Court noted that national banks “are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation.”¹⁴ The OCC does not dispute this basic proposition.

The courts have continued to recognize that national banks are subject to state laws, unless those laws infringe upon the national banking laws or impose an undue burden on the performance of the banks’ federally-authorized activities. In *McClellan v. Chipman*,¹⁵ the Supreme Court held that the application to national banks of a state statute forbidding certain real estate transfers by insolvent transferees was not preempted as the statute would not impede or hamper national banks’ functions. In *Wichita Royalty Co. v. City Nat. Bank of Wichita Falls*,¹⁶ the Court upheld the application of state tort law to a claim by a bank depositor against bank

¹¹ *Barnett Bank*, 517 U.S. at 33 (1996).

¹² 12 C.F.R. § 7.4009(c) (2009). The OCC adopted this rule in 2004, noting that these laws do not attempt to regulate national banks’ activities, but rather form the legal infrastructure that makes it practicable to exercise a permissible Federal power. 69 Fed.Reg. 1904, 1912 (Jan. 13, 2004).

¹³ *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353 (1869).

¹⁴ *Id.* at 362 (1869).

¹⁵ 164 U.S. 347 (1896).

¹⁶ 306 U.S. 103 (1939).

directors. And in *Anderson Nat. Bank v. Luccett*,¹⁷ the Supreme Court held that a state statute administering abandoned deposit accounts did not unlawfully encroach on the rights and privileges of national banks and, as a result, was not preempted.

As these cases demonstrate, there are numerous state laws to which national banks remain subject because the laws do not significantly impede or interfere with powers granted national banks under Federal Law. Yet, in reaching this conclusion, these cases serve to confirm the fundamental principle of federal preemption as applied to national banks: that is, that the banking business of national banks is governed by federal standards. These uniform national standards and the federal supervision under which national banks operate are the defining attributes of the national bank component of our dual banking system.

III. The Dual Banking System and Uniform Federal Standards for National Banks

In establishing the national banking system, Congress opted not to abolish existing private state banks, but rather to adopt a new framework in which national banks would be governed by uniform federal standards.¹⁸ With this design, the state and national banking systems have grown up around one another, creating the “dual banking system” we know today.

A. Benefits of the Dual Banking System

Encompassing both large institutions that market products and services nationally and very small institutions that do business exclusively in their immediate communities, the dual banking system provides both banks and consumers with significant benefits. These benefits flow from the competitive dynamic between the national and state systems when each component system is allowed to function in accordance with its distinctive attributes.

¹⁷ 321 U.S. 233 (1944).

¹⁸ The “very core of the dual banking system is the simultaneous existence of different regulatory options that are not alike in terms of statutory provisions, regulatory implementation and administrative policy.” Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 20 Stan. L. Rev. 1, 41 (1977).

1. States may serve as laboratories for innovative and new approaches

One of the well-understood benefits of the dual banking systems is that, by having a separate system of state banks, states may serve as laboratories for innovation and for new approaches to an issue, without compelling adoption of a particular approach by all states or as a national standard. That is, the dual banking system is built on the ability of individual states experimenting with different kinds of laws, including new consumer protection laws that apply to state banks in a given state, but not to state banks in all states and not to national banks. Over time, some of these individual state laws have proven to be good ideas, while others have not. When Congress has believed that a particular state's experiment is worthwhile, it has enacted that approach to apply throughout the country, not only to all national banks, but to state banks operating in other states that have not yet adopted such laws.

The national banking system, on the other hand, is the venue for efficiencies and benefits that flow from uniform national standards. This role is increasingly important as the market for financial products and services has evolved, as advances in technology have enabled banks to do business with consumers in many states, and as consumer financial products have become commoditized and marketed nationally. In other words, the national banking system is a laboratory, too, but what it demonstrates is the value of applying uniform national standards to activities and products that, today, have national markets.

2. Promotion of a diverse and flexible financial marketplace

In large part attributable to the competitive dynamic between its national and state banking components, the dual banking system has produced a remarkably diverse and innovative financial marketplace. Bankers can make choices between state and national bank charters on the basis of their business needs and particular circumstances. Businesses and consumers have a wide range of options in the marketplace, as financial institutions are encouraged to respond dynamically to

the changing needs of borrowers and depositors and to provide services and products in an efficient and cost-effective manner. In short, the dual banking system has been critical in producing a banking system that is able to finance growth and meet customer needs through innovation, responsiveness, and flexibility.¹⁹

Each component of the dual banking system makes different, positive contributions to the overall strength of the U.S. banking system. Efforts to dilute – or eliminate – the unique characteristics of one component of the system undermine the collective strength that comes from the diverse contributions of the two systems. The U.S. banking system as a whole, including the state banking component, benefits from the national banking system’s contributions, which flow from the efficiencies and benefits of operating under uniform national standards and a strong and uniform federal supervisory system.

B. The Existence of Federal Preemption as an Essential Characteristic of the Dual Banking System Established by Congress Does Not Disadvantage State Banks and the State Banking Charter

Notwithstanding the role that both the state and national banking components play in the collective strength of the dual banking system, some argue that federal preemption of state laws which interfere or impede with national banks’ activities – that is, the application of the Supremacy Clause of the U.S. Constitution – is somehow unfair to the state banking system.

This argument profoundly short-changes the State banking systems and the crucial role they play in the modern financial services marketplace. More fundamentally, however, the argument is backwards. National and State charters each have their own distinct advantages. Indeed, State banking supervisors vigorously assert that the State charter is superior. Numerous State banking department websites provide lists of the advantages of the State charter, often including a side-by-side comparison of fees and assessments to demonstrate the lower costs of a

¹⁹ See Susan S. Bies, Governor, Board of Governors of the Federal Reserve System, Remarks Before the Conference of State Bank Supervisors (May 30, 2003).

State charter.²⁰ One state banking department, after a listing of ten advantages of the State charter, concludes that the “state banking charter the charter of choice” for banks in that state.²¹ Some states have actively marketed the State bank charter, sending unsolicited letters, and even videos, touting the benefits of a State bank charter to national banks.

When all factors are considered, the number of national and state-chartered banks simply does not suggest that the principle of preemption has eroded the dual banking system.²² As of June 30, 2009, there were 5,490 FDIC-insured, state-chartered commercial banks, and 1,505 FDIC-insured, OCC-chartered national banks.²³ Far from signaling that state-chartered institutions are disadvantaged, these figures amply demonstrate the important role played by the state banking systems and the vitality of the dual banking system.²⁴

C. Benefits of the National Banking System and Uniform Standards of Operation and Supervision

From its establishment, the national banking system has been governed by uniform federal standards of operation and supervision. When a state law has impeded or significantly interfered with powers granted national banks under Federal law, the courts have held that under the Supremacy Clause the state law is preempted. Over the years, preemption of state laws that

²⁰ See, e.g., Texas Department of Banking, <http://www.banking.state.tx.us/corp/charter/benefits.htm>; California Department of Financial Institutions, <http://www.dfi.ca.gov/cacharter/advantages.asp>; South Dakota Division of Banking, <http://www.state.sd.us/drr2/reg/bank/banktrust/State%20Charter%20Comparison.pdf>;

²¹ Tennessee Department of Financial Institutions, <http://www.state.tn.us/tdfi/banking/charter.html>.

²² See “The Benefits of Charter Choice: The Dual Banking System As A Case Study,” prepared by the Conference of State Bank Supervisors and the American Bankers Association (June 24, 2005) (concluding the dual banking system “works,” fostering innovation, making products and services more widely available, and lowering costs). See also Testimony of Joseph A. Smith, Jr., North Carolina Commissioner of Banks, on behalf of the Conference of State Bank Supervisors, before the Committee on Financial Services of the U.S. House of Representatives (Sept. 23, 2009) (arguing that creation of a single federal financial regulator would undermine the dual banking system; state-chartered institutions and the financial system itself have benefited from the debate among state and federal regulators); Testimony of Joseph A. Smith, Jr., North Carolina Commissioner of Banks, on behalf of the Conference of State Bank Supervisors, before the Committee on Financial Services of the U.S. House of Representatives (July 24, 2009) (stating that the dual banking system has produced a diverse, dynamic, and durable banking industry and broad access to affordable credit).

²³ FDIC Quarterly Banking Profile (June 30, 2009).

²⁴ Jeffery C. Vogel, Conference of State Bank Supervisors Chairman, 2007-08, “CSBS Year in Review,” (May 21, 2008) (stating that “the state banking system is a significant and vital force in our local and national economies”).

impede or interfere with national banks' activities has fostered the creation of a set of predictable rules for national banks, which has lowered the costs of interstate banking and opened the financial marketplace. Such openness benefits both consumers and banks alike.²⁵

The banking system benefits from (1) greater economies of scale, as consumer products become commoditized and marketed in larger geographic areas; (2) improved risk management, as banks diversify across product offerings and across geographic markets; and (3) increased competition in the bank sector, a crucial factor in the continued vitality of the dual banking system. While these benefits accrue to all banks, they are especially important for smaller banking companies with customers in more than one state, where economies of scale and cost-effective risk management are critical if they are to operate efficiently.

D. Preemption and the Practical Impact of Applying State Laws to National Banks

As demonstrated above, important benefits flow from the ability of national banks to conduct their banking business under uniform national standards. Federal preemption of state laws that impede or interfere with national banks' activities preserves these uniform standards. Repeal or removal of federal preemption would create the potential for national banks to be subject to myriad state and local regulations and restrictions with significant practical impact on their banking activities. Such a balkanized approach would give rise to considerable uncertainty about which sets of standards apply to institutions conducting a multistate business. That, in turn, would generate major legal and compliance costs and impediments to product delivery for all banks, large or small.

For example, there are a number of areas in which complying with different standards set by individual states would require a bank to determine which state's law governs – the law of the

²⁵ Cf. Jith Jayaratne & Philip E. Strahan, "The Benefits of Branching Deregulation," FRBNY Econ. Pol'y Rev. 13 (1997) (finding that, as geographic restrictions on interstate branching were removed between 1978 and 1992, bank efficiency improved greatly, with reduction in operating costs passed along to consumers in the form of lower loan rates).

state where a person provides a product or service; the law of the home state of the bank; or the law of the state where the customer is located. It is far from clear how a bank could do this based on objective analysis, and any conflicts could result in penalties and litigation in multiple jurisdictions. Practical problems could arise from different grace periods for credit cards; different internet advertising rules; different solicitation standards for telephone sales, with different duties for sales personnel; different employee compensation limits; and different licensing requirements for new products.

On this basis alone, the maintenance of uniform national standards is compelling. But on at a more granular level – at the level of potential types of state regulation of national banks’ activities – the case in favor of preemption is forceful. In practical terms, there are generally three categories of state laws involved: 1) laws that prevent or impede the ability of a national bank to operate or offer a particular product or service; 2) laws that impose controls on pricing of particular products or indirectly affecting pricing by prohibiting specified terms; and 3) laws regulating the manner and means by which consumers are provided information about the bank’s financial products and services.

1. Preventing or impeding the ability of a national bank to operate or offer a particular product or service

The banking business of national banks is controlled by Federal law, specifically the National Bank Act (“NBA”), 12 U.S.C. § 1 *et seq.*, and federal regulations. The NBA authorizes national banks to engage in activities that are part of, or incidental to, the business of banking, plus other specified activities set forth in the NBA. When a state attempts to regulate a national bank’s activities by precluding national banks from operating within the state – where they are authorized to operate under Federal law – or to bar national banks from offering products or services – which they are authorized to offer under Federal law, the state is directly interfering with powers granted under Federal law. Such interference is fundamentally at odds with

Constitutional principles embodied in the Supremacy Clause. Examples of this type of state law include the following:

- Different states could impose licensing or product clearance requirements that could simply prevent national banks from providing certain products and services, or subject certain or new products and services to a state-by-state level pre-clearance.
- Different states could impose different capital or net worth requirements or security deposit requirements as preconditions for product providers operating in the state, such as net worth requirements for mortgage originators based on size or volume of business conducted in a state.
- Different states could specify requirements regarding the structures through which a bank must operate in order to provide certain products, based on a view that certain corporate structures or reporting lines are needed to effectively implement consumer protection objectives.

2. Imposing controls on pricing of particular products or indirectly affecting pricing by prohibiting specified terms

A second type of state law may attempt to impose controls on the pricing of particular products or indirectly affect pricing by prohibiting specified terms. A state could seek to impose direct price controls, by dictating how much a bank may charge for a product or service or when fees or other charges may be imposed, or may indirectly control prices, by prohibiting or conditioning the use of certain product features. Whether implemented directly or indirectly, such price controls represent the state telling a federally-chartered bank how much it can charge for particular products and services when no such pricing restriction exists under Federal law.

A national bank's authority to provide products or services to its customers necessarily encompasses the ability to charge a fee for the product or service.²⁶ This ability to charge a fee for the bank's products and services is expressly reaffirmed in OCC regulations.²⁷ As a result, state efforts to limit or otherwise control, directly or indirectly, the price a national bank may

²⁶ *Bank of America v. City and County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 538 U.S. 1069 (2003).

²⁷ 12 C.F.R. Section 7.4002(a) provides that "[a] national bank may charge its customers non-interest charges and fees, including deposit account service charges."

charge for its products and services are preempted and invalid under the Supremacy Clause.

Examples of these types of restrictions are:

- Different states could impose different limits on the rates of interest that may be charged to consumers in their states, and could prescribe different definitions of what types of charges constitute “interest” for purposes of each state’s “interest” rate cap.
- Different states could impose other limits or directives on particular terms and conditions of any consumer financial product offered by the bank. Banks could be required to offer specified products and services that conform to specified terms. States also could dictate particular product features, such as minimum payment requirements, grace periods, minimum periods for loan repayment, and early termination of mortgage insurance.

3. Regulating the manner and means by which consumers are provided information about financial products and services

A third type of state law may attempt to regulate how national banks conduct business by dictating the manner and means by which consumers are provided information about financial products and services.²⁸ For example, states could impose different disclosure requirements in connection with sales and solicitations of products or even requirements dictating the presentation and format of such disclosures. Examples of this type of state law requirement include the following:

- Different states could impose different disclosure requirements in connection with sales and solicitations of particular products.
- Disclosure requirements could dictate not just substantive content, but also presentation and placement of disclosures, further impeding the ability of consumers to comparison shop.
- Different states could impose different standards concerning manner of negotiation, sales and solicitation of particular financial products and services with respect to consumers in each state.

In recent years, the federal government and agencies have developed a much-expanded rulewriting process for developing standards for consumer disclosures, and other

²⁸ This type of law does not include a state law that embodies a business conduct standard, such as a prohibition on offering products and services in a manner that is unfair or deceptive, comparable to the standards in section 5 of the Federal Trade Commission Act.

communications, which convey important financial information to consumers. The process incorporates nationwide public comment process and extensive consumer testing to identify the information most meaningful to consumers and the most effective way to convey it to them. In the absence of preemption, a state could require – on any basis – that disclosures or communications take a form other than that required by the federal standards produced by this robust federal process. There is no basis to assume that the disclosure requirements imposed by any state – which would not be based on the comment process and testing used to develop a federal rule – would be better than the federal rule. For a national bank that operates interstate, the least costly option may be to cede to the requirements of the state with the apparently most extensive disclosure requirements, if doing so would satisfy the remaining states’ requirements. The practical result would then be that a single state’s requirements displace the standards promulgated in the federal rulemaking process, not just in one state, but in multiple states.

Permitting the states to adopt different disclosure requirements also has real downsides for consumers. As compliance costs increase, some portion of these costs is passed on to consumers of financial products and services. Yet, at the same time, consumers’ ability to look out for themselves and comparison shop for the best deal is undermined if differences in disclosure and communication requirements undermine their ability to compare products.

E. Preemption Incentivizes Robust Federal Standards

A key to the benefits of preemption described above is strong consumer protection standards at the federal level – a position the OCC agrees with.²⁹ In fact, preemption, when coupled with robust federal standards for national banks, operates as an incentive for the application of robust standards at the federal level that will apply to all participants in the

²⁹ See Testimony of John C. Dugan, Comptroller of the Currency, before the Committee on Financial Services of the U.S. House of Representatives, (Jun. 13, 2007) (setting forth in detail the OCC’s comprehensive approach to consumer protection regulation).

financial marketplace. With comprehensive robust federal standards in place to identify and resolve problems before they explode, there is no need for state “first responders” to arrive at the scene of a disaster, assess the damage and treat the wounded. Strong federal standards should prevent the disaster. Prevention, and not response, should be the first goal.

IV. Preemption Did Not Cause the Subprime Mortgage Lending Crisis

Some critics of preemption allege that it was a primary cause of the subprime mortgage crisis. This argument crumbles when facts and hard numbers are analyzed. The vast majority of subprime loans were originated by state licensed and supervised lenders and mortgage brokers, not federally-regulated banks. National banks had a limited share of subprime lending during crucial recent years, and those loans have a better performance record than nonbank subprime lending. Indeed, a portion of national banks’ loans labeled “subprime” was to low- and moderate-income borrowers in furtherance of banks’ CRA obligations. Community advocates and Federal Reserve researchers agree that these loans are of higher quality and have performed better than mortgages made by lenders not covered by CRA.

A. National Banks Did Limited Subprime Lending, and when National Banks Originated Subprime Mortgage Loans, Those Loans Have Performed Better than Subprime Lending as a Whole

On a nationwide basis, national banks and their subsidiaries accounted for approximately 12 to 14 percent of all non-prime originations, in the years 2005-2007, the peak years for non-prime lending.³⁰ The overwhelming majority of non-prime loans originated during this period were made by entities licensed and supervised by the states.³¹

³⁰ Letter from John C. Dugan, Comptroller of the Currency, to Elizabeth Warren, Chair, Congressional Oversight Panel (Feb. 12, 2009) (analyzing data from Loan Performance Corporation and Home Mortgage Disclosure Act data).

³¹ *Id.* See also Report and Recommendations by the Majority Staff of the Joint Economic Committee, “The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here,” at p. 17 (Oct. 2007) (“The mortgages underwritten by subprime lenders come from many sources, but the overwhelming majority is originated through mortgage brokers.”)

The subprime loans originated by national banks and their subsidiaries generally have performed better than subprime lending as a whole, with lower foreclosure rates.³² The OCC identified the ten mortgage originators with the highest rate of subprime and Alt-A mortgage foreclosures in the ten metropolitan statistical areas (“MSAs”) experiencing the highest foreclosure rates for the years 2005-2007. Of the 21 firms comprising the “worst 10” in those 10 MSAs, 12 firms – accounting for nearly 60 percent of non-prime mortgage loans and foreclosures – were exclusively supervised by the states. *See* Attachment A. The lower foreclosure rates generally indicate that the subprime loans originated by national banks were relatively higher quality and better underwritten mortgages.

B. A Portion of National Banks’ Subprime Lending Was Made to Low- and Moderate-Income Borrowers in Furtherance of CRA Obligations

A portion of the non-prime mortgage loan origination by national banks is traceable to efforts by national banks to fulfill their obligations to help meet the credit needs of their local communities, including low- and moderate-income (“LMI”) areas, under the Community Reinvestment Act (“CRA”). Potential borrowers in LMI areas tend to have lower credit scores – average credit scores in LMI census tracts are about 90 points less than average scores in other census tracts – placing many of them in the “subprime” category. National banks can and do lend to borrowers with lower credit scores, but to do so prudently the banks generally price the loans to cover the higher risk associated with lower credit scores. The annual Home Mortgage Disclosure Act (“HMDA”) data indicates that nearly 30 percent of mortgage loans with higher interest rates, so-called “rate spread loans,”³³ originated by national banks and their operating subsidiaries tended to be in LMI census tracts, even though those tracts account for only approximately 15

³² Testimony of John C. Dugan, Comptroller of the Currency, before the Committee on Financial Services of the U.S. House of Representatives, *supra* note 29; Letter from John C. Dugan, Comptroller of the Currency, to Elizabeth Warren, Chair, Congressional Oversight Panel, *supra* note 30.

³³ Rate spread loans and subprime loans are not exactly the same thing, but the HMDA data are more comprehensive and of higher quality than other data sources that focus narrowly on subprime loans, and the results likely are a good indication of overall tendencies in the market.

percent of national banks' mortgage lending overall. These numbers suggest a discernible share of subprime lending done by banks was done for CRA purposes.³⁴

This portion of subprime lending was not, as some have suggested, the cause of the subprime crisis. Where CRA-covered banking institutions made subprime loans in their assessment areas, in aggregate these subprime loans have performed better than subprime loans made by other types of lenders. For example, a study by the Federal Reserve Bank of San Francisco concluded that subprime origination volume by CRA-covered lenders within CRA assessment areas was relatively small, and that loans made by a CRA-covered lender within its assessment area are markedly less likely to go into foreclosure than loans made in the same area by lenders not subject to CRA.³⁵ A second Federal Reserve study found that mortgages originated and held in portfolio under the affordable lending programs operated by the NeighborWorks partners³⁶ across the country have, along any measure of delinquency or foreclosure, performed better than subprime and FHA-insured loans and have a lower foreclosure rate than prime loans.³⁷

In summary, a portion of national banks' non-prime loans were made to fill their obligations under CRA, but these loans did not cause the mortgage crisis. Subprime origination in CRA assessment areas was too small relative to the overall mortgage market to be a primary cause of the crisis, and subprime lending by CRA-covered lenders has been shown to outperform mortgages made by lenders not covered by CRA.

³⁴ These figures were derived through analysis of FFIEC data on credit scores and HMDA data on 1-4 family first lien mortgage origination.

³⁵ Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, "Lending in Low- and Moderate-Income Neighborhoods in California: The Performance of CRA Lending During the Subprime Meltdown" (Nov. 14, 2008), at pp. 14-16.

³⁶ Many loans originated through NeighborWorks programs are done in connection with CRA-covered institutions.

³⁷ Glenn Canner and Neil Bhutta, Board of Governors of the Federal Reserve System, Division of Research and Statistics, "Staff Analysis of the Relationship between the CRA and the Subprime Crisis," p. 3 and p. 8 table 3 (Nov. 21, 2008), at p.5 and table 9, p. 10.

VI. Conclusion

From its establishment, the national banking system has been governed by uniform federal standards of operation and supervision. These characteristics are fundamental to the distinctions that are the essence of the “dual banking system.” These uniform federal standards have fostered the creation of a set of predictable rules and consistent federal oversight for national banks, which has lowered the costs of interstate banking and opened the financial marketplace. The banking system benefits from greater economies of scale, improved risk management, and increased competition in the bank sector. In turn, consumers have benefitted from nationally uniform standards of consumer protection, the availability of a wider range of banking products and services and, overall, lowering the costs of credit and other banking products and services.

Attachment A

Worst Ten in the Worst Ten: Supervisory Status of Mortgage Originators

Originator	Supervisor	Foreclosures in Worst 10 Metro Areas, based on 2005-07 Originations
New Century Mortgage Corp.	State supervised. Subsidiary of publicly-traded REIT, filed for bankruptcy in early 2007.	14,120
Long Beach Mortgage Co.	State and OTS supervised. Affiliate of WAMU, became a subsidiary of thrift in early 2006; closed in late 2007 / early 2008.	11,736
Argent Mortgage Co.	State supervised until Citigroup acquired certain assets of Argent in 08/07. Held by Citigroup, new lending curtailed and merged into CitiMortgage (NB opsub) shortly thereafter.	10,728
WMC Mortgage Corp.	State supervised. Subsidiary of General Electric, closed in late 2007.	10,283
Fremont Investment & Loan	FDIC supervised. California state chartered industrial bank. Liquidated, terminated deposit insurance, and surrendered charter in 2008.	8,635
Option One Mortgage Corp.	State supervised. Subsidiary of H&R Block, closed in late 2007.	8,344
First Franklin Corp.	OCC supervised. Subsidiary of National City Bank. Sold to Merrill Lynch 12/06. Closed in 2008.	8,037
Countrywide	Data includes loans originated by (1) Countrywide Home Loans, an FRB and state-supervised holding company affiliate until 03/07, and an OTS and state-supervised entity after 03/07; and (2) Countrywide Bank, an OCC supervised entity until 03/07, and an OTS supervised entity after 03/07.	4,736
Amerquest Mortgage Co.	State supervised. Citigroup acquired certain assets of Amerquest in 08/07. Merged into CitiMortgage (NB opsub) shortly thereafter.	4,126
ResMae Mortgage Corp.	State supervised. Filed for bankruptcy in late 2007.	3,558
American Home Mortgage Corp.	State supervised. Filed for bankruptcy in 2007.	2,954
IndyMac Bank, FSB	OTS supervised thrift. Closed in July 2008.	2,882
Greenpoint Mortgage Funding	FDIC supervised. Acquired by Capital One, NA, in mid 2007 as part of conversion and merger with North Fork, a state bank. Closed immediately thereafter in 08/07.	2,815
Wells Fargo	Data includes loans originated by (1) Wells Fargo Financial, Inc., an FRB and state-supervised entity, and (2) Wells Fargo Bank, an OCC supervised entity.	2,697
Ownit Mortgage Solutions, Inc.	State supervised. Closed in late 2006.	2,533
Aegis Funding Corp.	State supervised. Filed for bankruptcy in late 2007.	2,058
People's Choice Financial Corp.	State supervised. Filed for bankruptcy in early 2008.	1,783
BNC Mortgage	State and OTS supervised. Subsidiary of Lehman Brothers (S&L holding company), closed in August 2007.	1,769
Fieldstone Mortgage Co.	State supervised. Filed for bankruptcy in late 2007.	1,561
Decision One Mortgage	State and FRB supervised. Subsidiary of HSBC Finance Corp. Closed in late 2007.	1,267
Delta Funding Corp.	State supervised. Filed for bankruptcy in late 2007.	598

