August 19, 1997

RE: New Jersey Licensed Lenders Act

Dear [ ]:

This responds to your inquiry to the Office of Thrift Supervision ("OTS") on behalf of [ ], a federally chartered savings bank located in [ ] (the "Association"), and its operating subsidiaries ("Operating Subsidiaries"). Your inquiry concerns whether federal law preempts the applicability of the New Jersey Licensed Lenders Act (the "Act") to the Association's Operating Subsidiaries when engaged in the proposed activities of making first and second mortgage loans secured by residential real estate in New Jersey.

In brief, we conclude that provisions of the Act would be preempted with respect to the Operating Subsidiaries making first and second mortgage loans to New Jersey residents secured by New Jersey residential real estate to the same extent as provisions of the Act would be preempted if the Association were engaging in the activities in question.

I. Background

The Association, through its Operating Subsidiaries, desires to engage in the business of making first and second mortgage loans to New Jersey residents secured by residential real estate in the State of New Jersey. You indicate that the Association's predecessor operated for a number of years as a [ ] chartered industrial bank. [ DATE OMITTED ], it converted to a federal savings bank (the Association) and retained its Bank Insurance Fund membership.

1 N.J. Rev. Stat. § C.17:11C-1 et seq.
The Act, which became effective on July 1, 1997, establishes a regulatory scheme over lenders subject to its provisions. The Act’s various requirements apply to mortgage bankers, mortgage brokers, mortgage solicitors, secondary mortgage lenders, consumer lenders, and others. The requirements include, but are not limited to, licensing, net worth standards, bonding, customer disclosure, restrictions on fees, and regulation of the terms of the loan contract.

The Act exempts “depository institutions,” which are defined to include federal savings banks, from all of the requirements of the statute that apply to mortgage bankers, mortgage brokers, mortgage solicitors, or consumer lenders, and from the license requirements that apply to secondary mortgage lenders. However, the Act provides that subsidiaries and service corporations of depository institutions are not exempt from those requirements.

II. Discussion

The OTS has on several occasions addressed the federal preemption of state laws that purport to regulate the activities of operating subsidiaries of federal savings associations. We have consistently indicated, both in regulations and in OTS opinions, that state laws that purport to regulate the activities of federal savings association operating subsidiaries are preempted by federal law to the same extent federal law preempts the state laws’ application to a federal savings association itself.

---

3 The terms “mortgage banker,” “mortgage broker,” and “solicitor” are defined in N.J. Rev. Stat. § C.17:11C-2. These terms generally refer to persons, not exempt under N.J. Rev. Stat. § C.17:11C-4, who perform such functions with respect to first mortgage loans.

4 The term “secondary lender” is defined in N.J. Rev. Stat. § C.17:11C-2 to include a lender who takes a second lien on residential real estate.

5 The term “consumer lender” is defined in N.J. Rev. Stat. § C.17:11C-2 to refer to a person making a loan of $15,000 or less that is not a first mortgage or secondary mortgage loan.


7 N.J. Rev. Stat. §§ C.17:11C-4a and C.17:11C-5a. The statute does not define the terms “subsidiaries” or “service corporations.”
The most recent statement of this principle is set forth in OTS's updated regulations on Subordinate Organizations, 12 C.F.R. Part 559 (1997). Section 559.3(n)(1) of the OTS regulations reaffirms OTS's long-standing view that state law applies to operating subsidiaries only to the extent that state law applies to the parent federal savings association. The preamble to the regulation explains the rationale behind this rule:

OTS has taken this position because an operating subsidiary – which may only engage in activities permissible for its parent federal savings association and must be controlled by the investing savings association – is treated as the equivalent of a department of the parent thrift for regulatory and reporting purposes.

The OTS's regulation of federal savings associations and interest in their safe and sound operation is not limited to the depository institution itself, but also reaches its subsidiaries. One of the reasons the OTS authorized federal savings associations to establish operating subsidiaries was to allow institutions to maintain control over an activity but better isolate and contain their liabilities than would be possible if it were conducted in the federal savings association itself.

When OTS initially issued its operating subsidiaries regulation in 1992, the regulation provided:

Unless otherwise provided by statute, regulation or policies of the OTS, all provisions of Federal laws, regulations and policies of the OTS applicable to the operations of a Federal savings association shall apply in the same manner and to the same extent to the operations of its operating subsidiaries, and the parent association and its operating subsidiary shall generally be

---


9 61 Fed. Reg. at 66,563. The specific requirements regarding a federal savings association's control of the operating subsidiary are set forth in 12 C.F.R. § 559.3(c)(1) (1997) and include the requirement that the federal savings association own, directly or indirectly, more than 50% of the voting shares of the operating subsidiary. The limitation on the permissible activities of an operating subsidiary is set forth in 12 C.F.R. § 559.3(c)(1) (1997).

consolidated and treated as a unit for the purpose of applying statutory and regulatory requirements and limitations.\textsuperscript{11}

The 1992 regulation also provided that "[e]ach operating subsidiary shall be subject to examination and supervision by the OTS in the same manner and to the same extent as its parent Federal association."\textsuperscript{12} Thus, operating subsidiaries were viewed as divisions or departments of their parent federal savings associations for virtually all regulatory purposes, including federal preemption. Moreover, the preamble to the 1992 regulation specifically noted that "state laws that may apply to the activities of an operating subsidiary will be preempted to the same extent as when the activities are conducted directly by a Federal savings association."\textsuperscript{13}

An OTS Chief Counsel Opinion issued on October 17, 1994 ("1994 Opinion")\textsuperscript{14} addressed the specific issue of whether certain state laws regulating lending were applicable to an operating subsidiary of a federal savings association. The 1994 Opinion examined provisions of two state statutes. An Arizona statute imposed requirements relating to licensing, registration, bonding and net worth requirements on any company that wished to engage in the mortgage banking business. A Maine statute imposed on any company that wished to originate consumer loans in the state, requirements regarding licensing, financial responsibility, and fitness of character, and restricted the taking of a security interest in real property for certain consumer loans. Both state statutes were found to be preempted and, therefore, inapplicable to the operating subsidiary.

The 1994 Opinion observed that the OTS's mandate under the Home Owners' Loan Act ("HOLA")\textsuperscript{15} is to regulate federal savings associations in a manner that preserves the safety and soundness of federal savings associations, protects the federal deposit insurance funds, and promotes the provision of credit in accordance with the best practices of thrift institutions in the United States. The 1994 Opinion also

\textsuperscript{11} 12 C.F.R. § 545.81(e) (1993).

\textsuperscript{12} 12 C.F.R. § 545.81(g) (1993).


\textsuperscript{14} OTS Op. Chief Counsel (October 17, 1994).

examined the OTS’s authority under § 5(a) of the HOLA to promulgate comprehensive regulations governing every aspect of the operations of federal savings associations. The 1994 Opinion concluded that because operating subsidiaries are an integral part of the operations of federal savings associations, the same regulatory approach must be applied to both if the agency is to fulfill its statutory mandate. While recognizing that operating subsidiaries are state chartered corporations, the 1994 Opinion reaffirmed the well-established principle that the federal government can preempt the application of state law to state corporations when doing so furthers a valid federal objective.

Based on OTS regulations and existing precedent, we conclude that state law would be preempted with respect to the Operating Subsidiaries’ proposed lending activities to the extent that state law would be preempted for a federal savings association engaging in the same activities. Thus, in examining the various provisions of the Act, it is necessary to determine whether a particular provision would be preempted for a federal savings association engaging in the activities. If a provision of the Act is preempted for a federal savings association, then it also is preempted for the operating subsidiary. It is clear, for example, that a state law may not impose a lender licensing requirement on federal savings associations, and so a state also could not impose such a requirement on an operating subsidiary of a federal savings association. Here, §§ C.17:11C-4 and C.17:11C-5 of the Act specifically exempt depository institutions, but not their subsidiaries, from various requirements, including, for example, licensing requirements that apply to mortgage bankers, mortgage brokers, mortgage solicitors, and secondary mortgage lenders. Even in the absence of the exemption for depository institutions, the Act’s licensing requirements would not apply to a federal savings association because of the preemptive federal regulatory scheme.

17 OTS Op. Chief Counsel (October 17, 1994) at 4-5.
18 Id. at 5 n.15; see also authorities cited therein.
19 Id. at 5-6 n.17; see also cases cited therein.
20 In this regard, reference should be made to the illustrative examples and preemption analysis in 12 C.F.R. 560.2 (1997), as well as case law and preemption opinions of the OTS and its predecessor agency, the Federal Home Loan Bank Board.
Because the license requirement could not apply to a federal savings association, 12 C.F.R. § 559.3(n)(1) specifically provides that an operating subsidiary of a federal association is not subject to the requirement. We conclude, therefore, that the Act’s licensing requirements would not apply to the Association’s Operating Subsidiaries. Conversely, if a provision of the Act is not preempted for a federal savings association, such provision would likewise apply to the Operating Subsidiaries.\(^\text{22}\)

In reaching these conclusions, we have relied upon the factual representations contained in the materials you submitted to us, as set forth in the background discussion above. Our conclusions depend upon the accuracy and completeness of these representations. Any material change in facts from those set forth herein could result in different conclusions.

If you have any questions regarding the foregoing, please contact Ellen Sazzman, Counsel (Banking and Finance), at (202) 906-7133.

Very truly yours,

/s/

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel

\(^{22}\) See, e.g., 12 C.F.R. § 560.2(c) (1997). We have not conducted an exhaustive analysis of the Act to determine whether each specific provision would, or would not, be preempted for federal savings associations and their operating subsidiaries. The principles and authorities we have outlined should enable you to perform such an analysis.