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Opinion No. 04-059

Effect of Federal Banking Rules on State Predatory Lending Laws

## QUESTIONS

1. The Office of the Comptroller of the Currency ("OCC") recently published two new rules regarding state laws preempted by federal banking laws and OCC visitorial powers (the "Regulations"). Under the Regulations, does the General Assembly have the authority to pass and the State to enforce consumer protection laws with regard to national banks and their non-bank subsidiaries?

2. Under the Regulations, does the General Assembly have the authority to pass and the State to enforce consumer protection laws with regard to state banks and their non-bank subsidiaries?

3. What effect do the Regulations have with regard to current Tennessee consumer protection laws that govern national banks and their non-bank subsidiaries?

4. What effect do the Regulations have with regard to the State's current consumer protection laws that govern state banks and their non-bank subsidiaries?

## OPINIONS

1. The Regulations explicitly provide that a national bank may make loans without state law limitations concerning such matters as licensing, loan-to-value ratios, terms of the loan, disclosure requirements, and interest rates. New section 12 C.F.R. § 7.4008(d); new section 12 C.F.R. § 34.4(a). While the General Assembly may still enact legislation addressing these issues, state authorities will be unable to enforce them against national banks or their operating subsidiaries.

2. The General Assembly has the authority to pass and the State to enforce consumer protection laws with regard to state banks and their non-bank subsidiaries. Under the current "wild card" statute, however, new state legislation on these subjects would not apply to state banks to the extent it does not apply to national banks. The statute, of course, continues to be subject to amendment by the General Assembly.

3. Whether any particular statute has been preempted under the Regulations will require an analysis of that statute and its effect on a national bank's exercise of its authorized powers. Clearly, the Regulations target state laws that directly regulate lending, for example, Tenn. Code

Ann. § 47-18-104. Any Tennessee statute that obstructs, impairs, or conditions the exercise of lending powers by a national bank or its operating subsidiary is probably preempted.

4. Under the current "wild card" statute, any consumer protection statutes that are preempted with respect to national banks and their operating subsidiaries would not apply to state banks and their operating subsidiaries.

## ANALYSIS

This opinion concerns the effect of final regulations recently issued by the Office of the Comptroller of the Currency (the "OCC"). These regulations appear at 69 F.R. 1895 (January 13, 2004) and 69 F.R. 1904 (January 13, 2004) (the "Regulations"). Of course, only the OCC can authoritatively interpret its regulations. This opinion is based on a review of the Regulations and accompanying explanation, as well as other interpretive rulings of the OCC.

A. Preemption

The request asks about the effect of the Regulations on the State's power to enact and enforce consumer protection laws against national banks and their subsidiaries. We assume that this question refers to legislation intended to protect consumers from various predatory lending practices. New rules regarding which state laws apply to national banks and which do not were published at 69 F.R. 1904 (January 13, 2004). These regulations amend 12 C.F.R. part 7, governing bank activities and operations, and 12 C.F.R. part 34, governing bank real estate lending. These regulations generally provide that any state law that obstructs, impairs, or conditions the exercise of lending powers or other powers by a national bank is preempted by the federal banking laws.

The regulations add a new section 7.4008 to 12 C.F.R. part 7. Paragraph (a) of the new regulation provides:

> 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.*

69 F.R. 1916 (emphasis added) (to be codified at 12 C.F.R. § 7.4008).

Paragraph (b) of the new section 7.4008 prohibits a national bank from making a consumer loan based predominantly on the value of the collateral rather than the borrower's ability to pay. Paragraph (c) of the new section prohibits a national bank from engaging in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act in connection with loans made under the regulation. Paragraph (d) addresses the applicability of state law, and provides:

> 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 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.

*Id.* (emphasis added). Paragraph (e) of the regulation provides that state laws on contracts, torts, criminal law, rights to collect debts, acquisition and transfer of property, taxation, and zoning are not inconsistent with non-real estate lending powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of this power. The regulation also provides that 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 described in Paragraph (a) of the regulation is not preempted.

The Regulations also amend federal regulations on real estate lending by national banks. Section 12 C.F.R. § 34.3 is amended by adding new paragraphs (b) and (c). These paragraphs provide standards for real estate lending that are similar to those provided for non-real estate lending in paragraphs (b) and (c) of the new section 12 C.F.R. § 7.4008. New section 12 C.F.R. § 34.4 addresses the applicability of state law with regard to real estate lending by national banks. The

regulation is similar to regulations regarding the exercise of other powers by national banks but contains some additional provisions particularly applicable to real estate lending. Paragraph (a) of this section provides:

> (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;
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> (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;
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> (10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;
>
> (11) Disbursements and repayments;
>
> (12) Rates of interest on loans;
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> (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.

69 F.R. 1917 (emphasis added) (to be codified at C.F.R. § 34.4). Paragraph (b) of the section is similar to the paragraphs discussed above preserving state laws on various subjects, with the addition of homestead laws specified in 12 U.S.C. § 1462a(f). *Id.* (to be codified at 12 C.F.R. § 34.4(b)(4)).

B. Visitorial Powers

New OCC rules on visitorial powers were published at 69 F.R. 1895 (January 13, 2004). Effective February 12, 2004, the rule amends 12 C.F.R. § 7.4000 to add a new paragraph (a)(3) and to revise paragraph (b). As revised, these provisions state:

> (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.

69 F.R. 1904 (emphasis added) (to be codified at 12 C.F.R. § 7.4000(a)(3) and (b)).

The OCC takes the position that the Regulations apply to the operating subsidiaries of national banks.[1] OCC regulations governing operating subsidiaries of national banks appear at 12 C.F.R. § 5.34. A national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly, either as a part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under any other statutory authority. 12 C.F.R. § 5.34(e)(1). An operating subsidiary includes a legal entity in which the parent bank owns more than fifty percent of the controlling interest, or the parent bank otherwise controls the operating subsidiary and no other party controls more than fifty percent of the controlling interest of the subsidiary. 12 C.F.R. § 5.34(e)(2). Under OCC regulations, therefore, "operating subsidiary" includes an entity that a national bank controls and that engages in activities in which the national bank may engage directly. It is clear that the OCC intends the Regulations to include organizations controlled by a national bank that engage in lending activities, such as mortgage lenders and industrial loan and thrift companies.

This Office, along with the Attorneys General of the remaining 49 states and the Virgin Islands and the District of Columbia Office of Corporation Counsel, signed a letter dated October

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[1] Even before the Regulations were issued, OCC rules provided that state laws apply to national bank operating subsidiaries to the same extent they apply to the parent national bank. 12 C.F.R. § 7.4006. The United States District Court for the Eastern District of California ruled that this regulation was a reasonable interpretation of the National Bank Act and that California state authorities could not examine a national bank subsidiary licensed as a mortgage lender under California law. *Wells Fargo Bank, N.A. v. Boutris*, 265 F.Supp.2d 1162 (E.D.Cal. 2003). *But see Minnesota v. Fleet Mortgage Corp.*, 181 F.Supp.2d 995 (D.Minn. 2001) (a bank subsidiary was not a "bank" exempt from the Federal Trade Commission's telemarketing sales rule, and the Minnesota Attorney General could enforce the rule against it).

6, 2003, opposing the promulgation of the Regulations on both policy and legal grounds. (Copy attached). Lawsuits pending in other states challenge preemption positions of the OCC that are based on the principles articulated in the Regulations. We anticipate that lawsuits challenging OCC's legal authority to promulgate the Regulations will arise in the future. A legislative response to the Regulations may also be forthcoming on the congressional level. This opinion will not attempt to outline the bases on which the Regulations may be challenged. Those matters are addressed in the October 6 letter. Now that the rules are effective, they are valid and binding until withdrawn, amended, impacted by an act of Congress, or found invalid in a binding opinion by a court of competent jurisdiction. This opinion will address the questions raised in the request regarding the effect of the Regulations as they are written and discussed by the OCC. Again, only the OCC can authoritatively interpret its own regulations.

1. Effect of Regulations on New State Consumer Protection Laws

The first question is whether, under the Regulations, the General Assembly has the authority to pass and the State to enforce consumer protection laws with regard to national banks and their non-bank subsidiaries. We assume the question refers to legislation intended to protect consumers from various predatory lending practices. It is clear that the OCC intends to preempt any state law that obstructs, impairs, or conditions the exercise of lending powers by a national bank, including its operating subsidiaries. The Regulations explicitly preempt state law restrictions on national banks' lending powers that concern licensing; insurance on collateral, private mortgage insurance, or other credit enhancements; loan-to-value ratios; terms of credit, including repayment and amortization; escrow accounts; security property; access to and use of credit reports; disclosure and advertising; disbursements and repayments; interest rates; sale and purchase of mortgages; due on sale clauses; and lease covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan. 12 C.F.R. § 7.4008(d); 12 C.F.R. § 34.4(a). While the General Assembly may still enact legislation addressing these issues, state authorities will be unable to enforce them against national banks or their operating subsidiaries.

2. Authority with Respect to State Banks

The next question is whether, under the Regulations, the General Assembly has the authority to pass and the State to enforce consumer protection laws with regard to state banks and their non-bank subsidiaries. State laws regarding state banks remain in force. The General Assembly has the authority to pass and the State to enforce consumer protection laws with regard to state banks and their non-bank subsidiaries. Under Tennessee's current "wild card" statute, however, new state legislation on these subjects would not apply to state banks to the extent it does not apply to national banks. The State's "wild card" statute appears at Tenn. Code Ann. § 45-2-601. It provides in relevant part that "any state bank may exercise any power or engage in any activity which it could exercise or engage in if it were a national bank located in Tennessee, subject to regulation by the commissioner for the purpose of maintaining the state bank's safety and soundness."

Under the last sentence of this statute, any power accorded by federal law to a national bank located in Tennessee is automatically extended to state banks, subject to regulation by the Commissioner of Financial Institutions for the purpose of maintaining the state bank's safety and soundness. Op. Tenn. Att'y Gen. 86-156 (September 2, 1986). Historically, this Office has interpreted this provision to permit state banks to exercise any power that national banks may exercise, subject to the same terms and conditions, and subject to state regulation to maintain the state bank's safety and soundness. Op. Tenn. Att'y Gen. 02-103 (February 1, 2002) (state banks may invest in a subsidiary licensed as a title insurance agent on the same terms and conditions as national banks); Op. Tenn. Att'y Gen. 89-69 (May 1, 1989) (state banks operating in towns of 5,000 or less, like national banks, may engage in insurance activities); Op. Tenn. Att'y Gen. 87-192 (December 16, 1987) (since national banks are not prohibited from charging document preparation fees in connection with their loans, state banks may also do so); Op. Tenn. Att'y Gen. 86-156 (September 2, 1986) (as a result of OCC regulations and federal case law, a state bank may operate an ATM without being subject to state law regulations and geographic restrictions).

Legislative history supports this construction. The present language was added in 1986 by Public Chapter 666. Senator Albright sponsored the bill in the Senate. He explained the bill as follows:

> This bill permits state banks to exercise the same powers as national banks. They have that power now, but under certain circumstances they may not. For instance, the federal regulators, the Comptroller of the Treasury that controls the national banks, may make a ruling that changes the scope of the national banks, but the state banks because it was not by statute would not come under that. This bill, or there could be a court decision, and by the time the legislature could meet to make that change is that [sic] the state banks would be at a disadvantage. This bill would give the state banks the same powers as national banks, and state banks' power would, if the powers of a national bank were changed, the state bank's would automatically be, too.

Senate Session March 19, 1986, Tape No. 53 (Remarks of Sen. Albright). The purpose of the "wild card" statute, therefore, is to preserve the competitive equality of state and national banks. Under the Regulations, national banks and their subsidiaries may exercise their powers free from any state law that obstructs or conditions the exercise of those powers. The national banks and their operating subsidiaries are subject to certain federal regulations. Through the operation of the "wild card" statute, state banks and their operating subsidiaries may exercise the same powers granted national banks, free from the same state laws, subject to the terms and conditions imposed by federal regulations, but enforced by state authorities. The exercise of these powers is subject to regulation by the Commissioner of Financial Institutions to maintain the state banks' safety and soundness. The statute, of course, continues to be subject to amendment by the General Assembly.

3. Current Consumer Protection Laws

The next question concerns the effect of the Regulations with regard to current Tennessee consumer protection laws that govern national banks and their non-bank subsidiaries. As discussed above, the Regulations expressly preempt any state law that obstructs, impairs, or conditions the exercise of lending powers by a national bank or its operating subsidiary. Comments to the regulations indicate that the Regulations are intended to preempt laws that have created "higher costs and increased operational challenges" for national banks, many of which operate in more than one state. 69 F.R. *at* 1908. As an example, the OCC cites the Georgia Fair Lending Act, which it found preempted in 68 F.R. 46264 (August 5, 2003). The Regulations explicitly preempt state law restrictions on national banks' lending powers that concern licensing; insurance on collateral, private mortgage insurance, or other credit enhancements; loan-to-value ratios; terms of credit, including repayment and amortization; escrow accounts; security property; access to and use of credit reports; disclosure and advertising; disbursements and repayments; interest rates; sale and purchase of mortgages; due on sale clauses; and lease covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan. Whether any particular statute has been preempted under the Regulations will require an analysis of that statute and its effect on a national bank's exercise of its authorized powers. Clearly, the Regulations target state laws that regulate lending activities by national banks, for example, Tenn. Code Ann. § 47-18-104. This statute, part of the Tennessee Consumer Protection Act of 1977, lists prohibited unfair or deceptive acts applicable to bank services, lending, or other activities conducted by national banks.[2] Any Tennessee statute that obstructs, conditions, or impairs the exercise of lending powers by a national bank or its operating subsidiary is probably preempted.

4. Effect of Regulations on Consumer Protection Laws with Regard to State Banks and Their Subsidiaries

The last question is what effect the Regulations have with regard to the State's current consumer protection laws that govern state banks and their non-bank subsidiaries. As discussed above, under the current "wild card" statute, any consumer protection statutes that are preempted with respect to national banks and their operating subsidiaries would not apply to state banks and their operating subsidiaries.

[2] The United States District Court for the Western District of Tennessee has already found that a claim under this section was preempted under the federal Fair Credit Reporting Act, 15 U.S.C. §§ 1681, *et seq. Carney v. Experian Information Solutions, Inc.*, 57 F.Supp.2d 496 (W.D. Tenn. 1999).

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