December 13, 2005

Robert E. Feldman
Executive Secretary
FDIC
550 17th Street, N.W.
Washington, D.C. 20429

Via e-mail: comments@fdic.gov

RE: RIN 3064-AC95
Notice of Proposed Rulemaking
12 CFR Parts 331 and 362
70 Fed. Reg. 60019 (October 14, 2005)

Dear Mr. Feldman

The Center for Responsible Lending (CRL)[1] submits these comments on the proposed rules, which were part of a larger package of preemption rules urged upon the FDIC by the Financial Services Roundtable. The trade association's petition for rule-making was the subject of an earlier request for public comment, 70 Fed. Reg. 13412 (March 21, 2005).

At the outset, we wish to commend the FDIC for its leadership among the federal financial regulatory agencies in advancing and protecting the dual banking system, which has proven so beneficial to our financial services system. We appreciate that this proposal recognizes that state banks have preemptive authority related to that of national banks pursuant to only two specific federal laws – Sections 24(j) and 27 of the Federal Deposit Insurance Act (FDIA).[2] CRL submitted extensive comments in response to the request for public comment on the precipitating Petition for Proposed Rulemaking, #6714-01-P, Comments of the Center for Responsible Lending (May 16, 2005). As did other commentators, CRL noted then that the petitioners' request sought preemptive parity with national banks far more broad than federal law supported. We commend the FDIC for limiting its proposals to those two bases.

[1] The Center for Responsible Lending is a non-profit organization focused on policy research and advocacy to stop predatory lending practices. We are an affiliate of Self-Help, one of the nation's largest nonprofit community development lenders, whose mission is to create and protect ownership opportunities for low-wealth families through home and small business ownership. Self-Help has provided $3.8 billion in financing to help over 40,000 low-wealth borrowers buy homes, build businesses and strengthen community resources. Additionally, our affiliate Self-Help Credit Union maintains deposit accounts for individuals, nonprofit and religious organizations, and foundations. Our organization was instrumental in helping to pass North Carolina's comprehensive state statute against predatory mortgage lending, the country's first, and has been a leader on legislative and regulatory efforts to address predatory lending issues nationally.

[2] Many states, of course, as a matter of state law have given state-chartered banks parity with national banks.

However, we nevertheless urge the FDIC to withhold promulgation of these rules at the present time. In our May 16, 2005 comments, we spelled out many concerns about the requested preemption under the two statutes, which give, to varying degrees, state banks preemption authority parallel to national banks. While we appreciate that the proposal is to go no farther than the situations covered by those two statutes, the concerns we articulated in the May comments about proposals within the sweep of those two statutes remain. We will not fully re-state those concerns and arguments, but we incorporate the May comments by reference, and urge the staff to review them as they relate to DIDA 521 (§ 27) interest rate preemption and Riegle-Neal II (§ 24(j)). For your convenience, we submit a copy of those comments as an appendix.

That the two authorizing statutes, DIDA § 521 and Riegle-Neal II,[3] are twenty-five and eight years old respectively demonstrate that there is no immediate need for implementing rules. While the proposed rules would primarily codify "me-too" interpretations of the OCC in parallel situations, we believe that it is premature to codify a status still in flux. "Preemption creep" is very controversial, and the boundaries of OCC-driven preemption are still being tested in the courts and in Congress. The lack of unanimity among stakeholders further illustrates the need to proceed with caution.[4] Given disagreement over OCC authority and continuing expansion of national bank preemption, the proposed rules would pursue OCC parity while there is still uncertainty and potential for additional confusion and ambiguity. (See Section II-B, below.)

Further, we believe that the proposed rules and supplementary information still presuppose a degree of parity that does not take into account the statutory and structural differences that remain even under the two authorizing statutes invoked here. A number of commentators, including CRL, noted the vital differences between preemption by national banks under the NBA, and preemption among state banks. We believe that the proposed rule glosses over the limitations to parity, as well as relevant limitations to FDIC authority. In doing so, the proposal will not bring additional clarity, as future practices of the banks will be tested against those very real limits.

At first blush, the proposed rules concentrate on either the settled (a federal definition of interest) or housekeeping detail (definition of "location", etc.) But in those "housekeeping" details lies both the potential to extend preemption in interstate banking

[3] Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, codified at FDIA § 27 (12 USC § 1831d), and Reigle-Neal II, Pub. L. 105-24, 1997).

[4] Adopting the Roundtable's proposal will not cure what is wrong with our system...I do not believe that it addresses the underlying problem, which is that the banking world has changed and we are all trying to deal with that change with unilateral actions. The effect of those one-sided actions has been to push the system out of balance. We should acknowledge that answering the OCC's pre-emption order with another, similar action will make the situation worse." Testimony of Diana Taylor, Superintendent of Banks for the State of New York at the FDIC public hearing on preemption petition, May 25, 2005. *See generally,* Testimony of John Allison, Chairmain, Conference of State Bank Supervisors at the FDIC public hearing on preemption petition, May 25, 2005 (Stating that the OCC's decision to preempt is very troubling, that this is "not merely a turf battle between the state and federal chartering agencies," and that due to divergent views of its constituents CSBS cannot fully support or oppose the petition but that "the state system remains as a structural curb of excessive federal regulatory burden and a means of promoting a wide diversity of financial institutions.").

well beyond Congressional intent, but and also to blur the distinctions between state and national banks even within the scope of DIDA § 521 and Riegle-Neal II.

Additionally, the proposed rules impermissibly restrict a state's opt-out under DIDA Section 525 to apply to only prevent a state's own banks from exporting its laws. It removes the state's capacity to protect its residents from other states importing its laws. This one-sided preemption shifts the opt-out away the congressional intent for states to retain some control to protect their residents from deregulatory agendas in other states. (See Section IV, below.)

Given the accelerating velocity of preemption creep, and the eagerness of the industry to achieve national "uniformity" by regulation where they have not by legislation,[5] it is foreseeable that at least some state banks will assume that they can look to OCC preemption rules (OCC §§ 7.4008, 34.4) in determining what state laws they can ignore even in their home state. As we discuss below, that is not the case. A great deal more analysis and precision is required to assure that any rules clearly articulate the points of divergence with OCC rules, not just the parity. Thus, in addition to being unnecessary, the proposed rule also fails to provide any additional degree of clarity to existing law, and may in fact lull institutions into a false sense of security in believing that they can do *anything* a national bank can do.

Protection of the dual banking system does not require the adoption of a rule that makes state banks vulnerable to instability. As we discuss in more detail in our comments, we believe that there are sound reasons not to proceed with the rule at this time, and that there is little, if anything to be lost by rejecting the proposed rules.

I. The FDIC has properly rejected the sweeping rule-making request of the Financial Services Roundtable.

A. Congressional intent generally favors a limited scope for preempting state banking law.

As a baseline for the scope of preemption of state law regulating state banks, it is very clear that Congress has not expressed an intention that federal law should fully occupy the field of banking – interstate or otherwise. In our May 16 comments, we discuss constitutional concerns particularly relevant to the "sister-state" preemption that distinguishes the national bank and state bank situations (Comment, § I-A-2, pp. 4-7), and the expressed intent of Congress that there remain a balance of federal and state control of banking law (CRL Comments § I-A-1, p. 3-4). This balance cannot help be threatened when federal law is interpreted so as to facilitate the preemption of one state's laws by those of another. Those remain concerns despite the proposed rule's more narrow scope than the original petition. In fact, OCC interpretations which this rule seeks to replicate well demonstrate how that agency's "preemption creep" has undermined, rather than implemented, the limitations inherent in Section 85 and

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5 *See* CRL May 16, 2005 comments, pp 16-19**.**

Congressional directives in Riegle-Neal clearly instructing that host state laws be respected, not circumvented wherever possible. (See, e.g. Section III B, below.)

B. The FDIC's role is unique among the federal banking regulatory agencies. Its principal role is as a fiduciary of deposit insurance funds and failed banks, not as a primary regulator. As its role *vis-à-vis* both states and banks differs from other federal regulators, it should err on the side of caution.

The FDIC has a unique role as guardian of the health and sustainability of the banking system at both the federal and state levels. Its primary role is to act as the fiduciary for the deposit insurance funds, as well as fiduciary in its role as receiver or conservator for most failed banks. It has a unique responsibility to ensure that depository institutions are operating in a manner that does not improperly jeopardize the insurance funds or the institutions themselves. In contrast to the other federal banking regulators, the FDIC does not have the express or implied statutory authority to be the primary regulator responsible for governing or authorizing all of the activities of insured state banks and any affiliate or 'other person' with which the bank decides to associate.[6] While the primary federal banking regulators have been accused, even by those within the financial services industry of "empire-building," and "charter competition,"[7] the FDIC's role is to cooperate, not compete with states, in relation to these state-created institutions. It shares its regulatory authority with states, and thus should be exceptionally sensitive to overstepping.

We are reassured that the FDIC has chosen to propose rules that acknowledge the limited scope of the FDIC's rule-making authority: to address the interest rate preemption under Section 27, and the interstate branching issues under 24(j), for the only sources of any degree of parity with national banks are found in these two statutes.

The FDIC commentary about the proposed rules affirms this limited nature of the preemptive authority: As to Riegle-Neal II, it states "[n]evertheless, the preemption provided by section 24(j) only operates with respect to a branch in a host state of an out-of-state, state bank. By its terms section 24(j)(1) and therefore the proposed regulation, would not apply if the out-of-state, state bank does not have a branch in the host state."[8] As to Section 27, the supplementary information recognizes that it grants solely "interest rate parity." (70 F.R., at 60025) The commentary thus expresses a clear intent to respect the explicit limitations of the preemptive authority and to fashion specific rules tailored to that restricted scope.

While we are relieved that the FDIC's proposed rules do not reflect the sweeping scale of those requested by the Financial Services Roundtable, we are still concerned that the

[6] Indeed, some of the egregious fair lending and consumer protection problems raised by the payday lending activities of some insured state banks might be considered evidence of the limitations of this distinction

[7] *See, e,g,* sources cited in CRL May 16, 2005 comments, pp 3, note 2.

[8] *See* FDIC Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 198 at 60025 (Oct. 14, 2005)

rules as written nevertheless could have unintended costs that could damage the viability of the banking system. FDIC guidelines have contributed to reducing payday activity, but the proposed rule could encourage additional payday lending directly by state banks in states that have sought to prohibit payday lending, could encourage abusive financial practices over the internet, and could increase abusive credit card activity. The proposed rule and possible future expansion of the rule could have significant consequences for borrowers, facilitating the expansion of abusive lending practices.

II. It would be premature to codify the proposed rules at this time, and there is no countervailing immediate need for such codification.

A. There is no additional advantage over the status quo to be gained for state-chartered banks by immediate enactment of the Proposed Rules.

There is no countervailing need for codification at this time. As to the limited interest rate preemption authorized by Section 27, the FDIC has adopted § 7.4001 by agency opinion letter,[9] and legal precedent is consistent in applying Section 27 as to state banks similar to Section 85 as to national banks.[10]

Hence, it is unclear why codification is needed for clarification. The promulgation of the proposed rule is not necessary given settled law in this area. In contrast, what is not said in these rules about the limits of parity is likely to generate a great deal more uncertainty.[11]

In light of the continued debate about the legitimacy of the "coattail" rules, and the failure to highlight the limits of parity, codification could have the harmful effect of setting a policy direction that would result in future FDIC actions to issue expanded preemption rules in the future.[12]

B. It is premature to codify OCC preemption interpretations while the breadth of those interpretations are still under scrutiny, and in light of ongoing concerns about the legitimacy of the OCC's preemption agenda and action at this stage would be harmful.

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[9] The FDIC adopted the OCC's Interpretive Ruling for defining charges that constitute interest under section 27 of the FDIA. *See* FDIC General Counsel's Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17, 1998); Gen. Counsel's Opinion No. 11, 63 Fed. Reg. 27,282 (May 18, 1998) (discussing impact of Riegle-Neal Act and Riegle Neal Amendments Act on Section 27 interest rate exportation). Neither opinion, however, discusses whether Section 27 also extends to non-banks who enter arrangements with insured state banks.

[10] *See Infra* for discussion of OCC letter 822. It does not appear that there is a separate interpretation regarding the location of banks and therefore does not need to have a codified clarification of such.

[11] We discuss *infra* the potential damages of promulgating these rules to the constituents of the FDIC.

[12] "The banks that are encouraging you to adopt this position are going to be sadly mistaken if they think they're going to get clarity out of any result. If you have the authority, and I don't think you do to do this, …it is less clear.…If you adopt the petition, it's going to be in litigation for five or six years. My recommendation to you on behalf of the citizens of Maryland and the banks that are regulated and the non-banks that are regulated is pass on this." Testimony of Charles Turnbaugh, Commissioner of Financial Regulation, State of Maryland at the FDIC public hearing on preemption petition, May 25, 2005.

It would be unwise for the FDIC to attempt to extend preemptive authority based entirely upon OCC preemption as that is still being tested and examined in both Congress and the courts. In our May 16 comments, we shared the bi-partisan concerns about the OCC's actions in this area.[13] And at the May 25 hearing Diana Taylor, Superintendent of Banks for the State of New York succinctly opined on the perils of moving forward with preemption: " A solution I don't think is to compound what the OCC started by giving every state the right to preempt every other state. We must seek to maintain a system where the laws and regulations are reasonable and consistent and where if they are followed, one is not so constrained as to be able to conduct business."[14]

Yet it is clear that the impetus for the rule-making petition was these recent aggressive and expansive preemption efforts by the OCC. Some of these efforts remain under challenge in the courts, and the subject of pending legislation in Congress. A petition for certiorari has been filed on the question of the OCC's extension of preemption authority to operating subsidiaries of national banks.[15]

The promulgation of 7.400 *et. seq.* regarding what state laws are preempted raises as many questions as it answers. For example, although the rule itself says that state laws on debt collection are not preempted[16], and OCC officials have assured Congress that state UDAP laws are not preempted, the federal government is in court in California as an amicus to a national bank taking position in support of preemption which are contrary on both counts.[17]

As we noted in May, criticisms for OCC overreaching were bi-partisan in oversight committee hearings and legislation has been introduced to clarify that the OCC has acted beyond Congressional mandate in its sweeping preemption.[18] Additionally, the OCC's preemption actions have been the subject of increasing attention from academics and commentators outside the industry.[19] The FDIC has already issued interpretations that

[13] *See* May 16 comments filed by the Center for Responsible Lending (containing examples of both Democrat and Republican positions that the OCC has, unwisely and at great risk to the financial systems and citizens of the United States, broadly overreached in its aggressive extension of preemption in the field of banking).

[14] Testimony of Diana Taylor, Superintendent of Banks for the State of New York at the FDIC public hearing on preemption petition, May 25, 2005.

[15] *See* Wachovia Bank, N.A. v. Burke, 414 F.3d 305 (2nd Cir.(Conn.) Jul 11, 2005) (NO. 04-3770-CV), *Petition for Certiorari Filed, 74 USLW 3233 (Sep 30, 2005)(NO. 05-431).*

[16] *See* OCC Interpretative Rule 7.4008(e)(4).

[17] *See* Miller v. Bank of America, 2004 WL 3153009 (Cal. App. Super.) and *Amicus Curiae Brief of the United States in support of Appellants/Cross-Appellants*, Miller v. Bank of America (filed October 31, 2005).

[18] *See* S. 1502, H.R. 3426 (109th Cong.).

[19] See, e.g. Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 Temple L. Rev. 1 (2005); Azmy Baher, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 Fla. L. Rev. 295 (2005); Nicholas Bagley, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y. U. L. Rev. 2274 (2004). *Cf.* Roderick Hills, *Against Preemption: How Federalism Can Improve the National Legislative Process*, University Of Michigan Law School, John M. Olin Center for Law and Economics, Working Paper 16 (2003), *available* *http://law.bepress.com/umichlwps/olin/art16*.

provide adequate guidance (and legal cover) for state chartered banks during this period of flux. There is nothing to be gained by formally enacting these rules now, and in fact, a decision to step into this perceived vacuum will directly cause a diminution of respect for the limits of parity.

III. The Proposed New Rules Will Not Provide Greater Clarity. They Do Not Provide Clear Guidance on the Limits of State Bank Parity and Would Codify Positions Even the OCC has Not.

A. The Proposed Rules State or Imply a More Complete Parity with National Banks than the Relevant Statutes Authorize.

The federal statutes underlying the proposed "me-too" rules are the "most favored lender" provision of DIDA §521/ FDIA § 27's (12 USC § 1831d) and Riegle Neal II, (12 FDIA § 24(j) (12 USC § 1831a(j)(1). There is a significant difference in the two statutes as to the scope of parity they give state banks to national banks. While the differences are acknowledged in the Supplemental Information, (e.g. 70 F.R. at 60025), the commentary also refers in other places loosely to national bank parity in sweep more broad than the underlying statutes warrant. The result, we fear, is that the differences and limitations are not adequately reflected in the proposed rule. Failure to do so will almost assuredly generate more confusion, and additional "preemption creep."

1. Structural differences in Section 27 and 24(j) create different boundaries for state bank's parity with national banks.

Interest Rate Preemption: Section 27 is an independent grant of a limited right of preemption. Specifically, it allows a federally-insured, state-chartered depository the right to charge the "interest rate" allowed by the "most favored lender" making similar loans in its home state. Neither it, nor the language of Section 85 of the National Bank Act, which it parrots, preempts all state law governing interest rates in its home state. Rather, it preempts state laws only to the extent that it allows a bank to "borrow" a state interest rate cap that would allow another type of lender a higher rate when it made that same type of loan.[20] Its broader preemptive effect in the interstate context is indirect – the "preemption by exportation" that crept in with the Supreme Court's decision in *Marquette.*[21]

Since this "most favored lender" provision in § 27 parallels NBA § 85, it is to be construed "in para materia" with that section.[22] As an independent grant of authority, which parrots, but does not incorporate by reference the rights of national banks, it is not, and cannot be construed as, a statutory basis for full "piggy-back parity" with national banks. The *in para materia* construction gives effective parity, but <u>only</u> where

[20] It would allow banks to decide to charge an alternate federal discount rate instead of borrowing a state law applicable to the most favored lender in that state. As a practical matter, that alternate federal discount rate appears to be rarely, if ever, the choice of either national banks or state banks.
[21] *Marquette National Bank v. First of Omaha Service Corp.* 439 U.S. 299 (1978).
[22] *Greenwood Trust Co. v. Commonwealth of Mass.*, 971 F.2d 818 (1st Cir. 1992).

the national banks' preemption authority is derived from § 85. Where national banks get the benefit of preemption under NBA § 24(Seventh), or a combination of NBA § 24 (Seventh) and § 85, state-chartered institutions cannot use § 27 to claim preemption. It is this limitation which the proposed rule fails to make clear, and which will almost assuredly lead to yet more unwarranted preemption creep without considerably more precision and detailed guidance.[23]

Riegle-Neal II : In contrast to the independent grant of parallel "most favored lender" rights under § 27, Riegle-Neal by its own terms directly piggy-backs the state banks' rights onto the national banks rights. 12 USC 1831a(j). Thus unlike the interest rate preemption, state banks' preemption rights are derivative of national banks' rights in the context of interstate branching. This is a parity statute. Even so, it does raise a question for the FDIC, as an independent agency with a different role and different regulatory mission, as to the propriety of following OCC interpretations which themselves are questionable.

2. Failure to define the limits of parity with national banks under Section 27 is likely to lead to greater confusion among state banks as to where the boundaries are.

It may be helpful to explore how state bank parity under § 27 is limited with specific examples of situations where the proposed rule may well lull state banks into a false confidence about modeling their actions on a national banks'.

* *Operating subsidiaries*: Perhaps the most glaring example is suggested in the supplementary information to the proposed rule itself. While the rule does not propose an operating sub rule parallel to OCC Rule § 7.4006, the commentary states that § 27 preemption applies to state banks operating subs "to provide parity" with national banks, (70 F.R. at 60027). That is beyond the sweep of Section 27.

First, we note that even as to national banks, the validity of the rule has yet to be finally established. A petition for certiorari on the validity of this rule is pending before the Supreme Court. Wachovia Bank, N.A. v. Burke**,** 414 F.3d 305 (2nd Cir.2005, *Petition for Certiorari Filed, 74 USLW 3233 (Sep 30, 2005)(NO. 05-431).*) But more fundamentally for purposes of this proposed rule-making, the predicate for the OCC rule is not NBA § 85. Rather, it is in NBA § 24, which has no parallel in the FDIA, *Id.*

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[23] A looming issue is whether the OCC would support efforts to effectively eliminate the fundamental premise of a borrowed home-state law governing "interest" under Section 85, by arguing that Section 24 permits preemption of <u>all</u> state laws governing "the terms of credit." The relationship of OCC Rule 7.4001 to OCC Rules 7.4008(d), 7.4009 and 34.4(3) has not been fully explored. While the OCC gives nod to the distinction in footnotes to those rules, the combined effect of the rules and the OCC's history warrant concern for this as another area of preemption creep. As to state banks, of course, the major distinction is that the OCC could not predicate such a position on Section 85 alone, and therefore a state bank would not have parity with a national bank in the same home state for exportation purposes.

Therefore, since § 27 is an independent but limited grant of preemption rights, where just the subject matter of that provision itself is to be read *in para materia* with its parallel NBA § 85, there is no basis whatsoever in the FDIA to extend § 27's interest rate preemption to operating subsidiaries of state banks.

* *Credit Card Change in Terms notice.* A state law requires a 60-day notice of change in terms for open-end credit, and limits the ability to impose new terms which adversely affect the consumers' rights as to balances incurred prior to the effective date of the change. (*E.g*. Iowa Code § 537.3205.) Four years prior to the promulgation of the sweeping OCC 2004 preemption rules, the OCC was asked by an industry representative for a determination that NBA § 85 permitted an exporting credit card issuer to use its home state's more permissive change in terms law. The OCC declined to do so,[24] and rightfully so, for that does not fall within the scope of even the OCC's broad interpretation of "interest." In the absence of a specific tie to preemption rights under § 85, there is no parallel right of a state chartered bank based in Delaware to export Delaware's change in term law to Iowa customers under § 27.

Even if the OCC today were to say that a national bank could ignore Iowa law under the 2004 sweeping preemption rules, OCC Rule 7.4008 would **not** give parallel preemptive authority as to that term to a state chartered bank, for OCC Rule 7.4008 is predicated on a combination of NBA provisions which are not incorporated into the FDIA.[25] Without clear articulation of the limits of parity under FDIA Section 27, some exporting state-chartered bank would almost assuredly assume it could do whatever its fellow exporting national bank issuer could do in this regard.

* *Preservation of Claims and Defenses laws:* Some states have laws which place limits on or eliminate the holder in due course doctrine for certain types of transactions, including state anti-predatory mortgage lending laws. This is not an "interest rate" provision.[26] Irrespective of what the OCC may tell a national bank about preempting state law on assignee liability,[27] a state-chartered institution doing mortgage lending on the Internet cannot utilize § 27 or any implementing rule to claim it can ignore such a law.

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[24] Report to the Federal Preemption, Conflict of Laws and Usury Subcommittee, Committee on Consumer Financial Services, Section of Business Law, American Bar Association, (January 7, 2001). Given the willingness to provide such interpretations normally, the logical conclusion is that it did not believe

[25] It is also based on a reversal of the normal standards of preemption generally, and it is just such interpretations that generate the controversy which leaves the ultimate outcome still unsettled. See, e.g. Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection,* 23 Annual Review of Banking Law, 2004)

[26] It was held to be not "material to a determination of the interest rate" in one of the first cases addressing the National Bank Act's most favored lender provision in detail. Attorney General v. Equitable Trust Co., 450 A.2d 1273 (Md. 1982).

[27] For example, the OCC has determined that the Georgia Fair Lending Act is preempted in virtually all respects. Preemption Determination August 5, 2003 (68 Fed. Reg. 46264 (Aug. 5, 2003), Interpretive Letter No. 1000 (April 2, 2004). Yet it does so through a combination of NBA provisions, and NBA § 85 is not the basis for preempting the GFLA's assignee provision, Ga. Stat. §7-6A-6(b).

* *Agency and Third Parties:* National banks that use third parties in connection with their lending business do so under authority derived from the National Bank Act. Specifically, section 24 (Seventh) of the NBA provides national banks with the right "[t]o exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking . . ." (emphasis added). Based on this statutory authority, the OCC promulgated 12 C.F.R. § 7.1004, which states that "[a] national bank may use the services of, and compensate persons not employed by, the bank for originating loans."

Thus, according to the OCC, the ability of national banks to originate loans through agents to derives from Section 24(Seventh) of the NBA and 12 C.F.R. § 7.1004 rather than Section 85 of the NBA, which relates to interest rate exportation. In 2001, the OCC opined that a Michigan law attempting to regulate loans offered by a national bank through a non-bank third party should be preempted because a national bank has express powers to engage in activities incidental to its business pursuant to Section 24(Seventh) and has the express authority to use the services of non-banks pursuant to 12 CFR §§ 7.1003 and 7.1004. Preemption Determination, 66 Fed. Reg. 28,593 (May 23, 2001). The OCC's analysis began with a discussion of the power of national banks to originate loans and then moved on to a discussion of national banks' authority to use the services of third-party agents in their lending business. The OCC concluded the source of the authority was Section 24(Seventh) and regulations promulgated under that statute:

> First, section 24(Seventh) specifically authorizes national banks to make loans. Thus, a national bank need look no further than the express language of the statute for authorization to make loans. Section 24(Seventh) also authorizes national banks to engage in the more general "business of banking" and activities incidental thereto. . . . An activity will be deemed "incidental" to the business of banking if it is "convenient or useful in connection with the performance of" a power authorized under Federal law. Arnold Tours, Inc. v. Camp, 472 F.2d 427, 432 (1st Cir. 1972).
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> Second, the authority of national banks under section 24(Seventh) permits a national bank to use the services of agents and other third parties in connection with a bank's lending business. Federal banking regulations specifically provide that a national bank may "use the services of, and compensate persons not employed by, the bank for originating loans." 12 CFR 7.1004(a).

Preemption Determination, 66 FR at 28,595. Only after concluding that the national bank has the authority to use the services of a third-party in connection with making a loan did the OCC address the question of which interest rate the bank may charge.

There is constant innovation at the street-level as lenders seek to maximize profits through creating new versions of products and new subterfuges in order to circumvent applicable restrictions. State banks have chosen in recent years to engage with non-bank third parties that also provide financial services on a standalone basis and engage exclusively in the business of banking in some markets. These non-banks provide products such as title and payday loans that have been found to be problematic by state regulatory agencies as well as the FDIC itself.[28]

Despite the well-documented problems with these and similar loan products, state enforcement authorities and legislatures have had only limited success in combating these abuses, in large part because non-bank lenders claim that state law applicable to them is preempted by the FDIA. The FDIC contributed to this regulatory problem by declining to clarify that Section 27 exportation privileges in this context are limited to the bank alone.[29] The FDIC then compounded the confusion around Section 27 with its non-binding opinion letter purporting to adopt for application to insured state banks an OCC preemption determination discussed *supra*, a determination based in NBA Sections 85 *and* 24 (Seventh).[30] This ongoing lack of clarity is a prime factor in the passage of non-comprehensive state laws regarding payday lending as well as confusion and lack of enforcement will among state regulatory agencies. The proposed rules cannot bridge the gaps in the statutory authority for state banks and their non-bank associates and therefore will not bring clarity to this burgeoning issue.

B. "Location, location, location:" An Illustration of the Interpretations that Swallow the Congressional Mandate of Riegle-Neal and the Limits of Section 85.

In these definitional housekeeping rules lies a challenge for the FDIC's role as an independent agency**.** In direct contrast to the FDIC, the OCC's has articulated a goal of using preemption to achieve uniformity. [31] That is clearly neither within the scope of the FDIA, nor is it a goal of the FDIC. Should the FDIC rules be interpreted to grant state-chartered banks full hitch-hiking rights to ride along with OCC rules, those states which try to balance the interest of all their citizens will lose the right to protect their citizens even within their own borders. Despite the grant of similar authority with respect to branching under Riegle-Neal II, such an outcome is also directly contrary to Congressional intent as expressed in Riegle-Neal itself and in federal consumer protection laws.[32]

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[28] The FDIC was forced to revise its Guidelines for Payday Lending after examinations turned up numerous violations of the Guidelines issued twenty-one months previous.

[29] The OCC did make such a clarification: The OCC, along with OTS, did make just clarification by joint statement by Comptroller Hawke and Director Seidman, declaring that these third party vendors "should not 'assume that the benefits of the bank or thrift charter should accrue to them'." OTS Joint Release 00-99, November 2000.

[30] *Does Section 27 of the Federal Deposit Act Preempt the Michigan Motor Vehicle Sales Finance Act,* FDIC-02-06 (Dec. 19, 2002) 2002 WL 32361502 at *7.

[31] See, e.g. 69 Fed. Reg. 1904, 1908-1908 (Jan. 13, 2004). The effect is to maximize federal preemption of state law, replacing it either with federal law, or maximum latitude to client banks to utilize state laws of their choice. That choice of the most permissive state law comes into play both for exportation and for interstate branching purposes.

[32] Since that position was expressed by Congress in Riegle-Neal I as to <u>both</u> national and state charters, (see CRL Comments of May 16, 2005 pp.10-12, 17) there is no inference in the parity amendment of Riegle-Neal II that it was impliedly reversing itself on the importance of state control.

Riegle-Neal explicitly singled out state consumer protection and fair lending laws as host state laws which should be observed. It further explicitly stated that by enacting this interstate banking and branching law, it was not expanding any preemption-by-exportation rights. Riegle-Neal I Section 111(3)**:**[33] Finally, it criticized the OCC for overreaching on preemption generally (even as to home state laws[34]), and, as a compromise action, mandated that the OCC promulgate any preemption interpretations for public comment.

As a preface to this discussion, it should be remembered that as a legal matter, legislative history is only utilized to interpret ambiguous statutes. Riegle-Neal is clear that a) it does not expand the "exportation by preemption" rights, and b) certain categories of host state laws must especially be respected. Yet the subsequent "housekeeping" interpretations from the OCC in essence allowed national banks to completely evade both those mandates. Moreover, that interpretation, proposed to be codified by the FDIC, was arguably itself adopted in violation of Riegle-Neal's demand that preemption interpretations be published for public comment.

The OCC issued Interpretive Letter 822, effectively expanding the preemptive scope of NBA Section 85, without publication for comment as required by Riegle-Neal I, §114. This was justified by the simple expedient of declaring it was not a preemption interpretation. Yet its effect is just that. The letter was written in response to an industry request, which spelled out its arguments and the desired interpretation.[35] Less than two months later, without publication, the OCC adopted that requested position. OCC Letter # 822, February 17, 1998.[36] It is that letter, which tells banks how to circumvent any "location" restrictions inherent in Section 85, and which was arguably issued by the OCC in violation of RN itself, which the FDIC proposes to codify in proposed § 331.4.

Here, too, there is nothing to be gained for the institutions, as the FDIC has adopted it as an interpretation. GC Op. No. 11, 63 Fed. Reg. 27282 (May 18, 1998). However, codifying this dubious OCC interpretation (in both content and process) would give it a heightened cloak of legitimacy which even the OCC has not pursued.

We also fear that the expansive definition of "activity conducted at a branch, proposed § 362.19(a)(4) may also be similarly manipulated to evade the intent of Congress that states may continue to assure some measure of consumer protection and fair lending for their

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[33] "No provision of this title and no amendment made by this title to any other provision of law shall be construed as affecting in any way ….(3) the applicability of [Section 85] of section 27 of the Federal Deposit Insurance Act."
[34] H.R. 103-651, pp 39 (e.g. national banks in New Jersey and state lifeline banking laws).
[35] Letter of Jeremy Rosenblum on behalf of The Huntington National Bank to Julie Williams, Chief Counsel of the OCC (December 23, 1997).
[36] The authors of the original request were pleased to announce their role in achieving this "ground-breaking interpretive letter." Letter to "Clients and Friends," from Jeremy Rosenblum and Alan Kaplinsky, February 18, 1998. The FDIC adopted OCC Letter 822 in GC Op. No. 11, 63 Fed. Reg. 27282 (May 18, 1998).

own residents. Riegle Neal I, II and DIDA §521 all demonstrate Congressional intent that states mandate some ability to assure that their citizens are protected from abusive lending practices. These "housekeeping" definitions,[37] in effect, allow that mandate to be avoided at the will of any given institution**.** We believe that the FDIC, as the one federal financial regulator whose focus is to work hand in hand with states, should be wary of giving the added legitimacy of a rule, where it is not necessary.

VI. Proposed Rule 331.5 impermissibly restricts the effect of a state's opt-out under DIDA Section 525.

We also believe that proposed § 331.5 misstates the intent, purpose and legal effect of a state's exercise of its right to opt-out under DIDA § 525. Irrespective of whether the FDIC proceeds with rule-making or delays it, the agency should not adopt that interpretation of the effect of an opt-out.

Though the effect of a § 525 opt-out is currently narrow, given the limited number of jurisdictions which have retained their opt-out, it is no less important that it be given its full due. As more and more states become concerned with federal "preemption creep," and as the experience with AMTPA demonstrates, states may wish to revisit their opt-out status.[38] As there was no sunset on the DIDA Title I, Part C opt-out right, they have the right to do so.

The effect of proposed rule §331.5 would be to make an opt-out a one-way fence. It would leave the state with no capacity to protect its own citizens from the activities of banks in other states; it would only prevent its own banks from exporting its own law to other states. That is a perversion of the opt-out. It also has not been the consistent position of the FDIC.

The limited legislative history of what became section 525 certainly did not indicate a congressional intent to leave consumers in opting-out states subject to a complete deregulatory agenda in other states.

> "State usury ceilings on all loans made by federally insured depository institutions (except national banks), and small business investment companies will be permanently preempted, subject to the right of affected states to override at any time**, <u>and a ceiling of 1 percentage point above the appropriate federal reserve discount rate will apply,</u>** except to transactions subject to the preemption of usury ceilings on mortgage loans[39] and on business and agricultural loans above $25,000."[40]

[37] Proposed rules §§331.4, 362.19(3).
[38] See CRL May 16 comments, pg. 10.
[39] The first lien mortgage loan preemption, also the subject of opt-out rights, was part of the same law. DIDA Title I, Part A.
[40] H.R. Conf. Rep. 96-842, 1980 USCCAN 298, 308-309.

Thus, far from sanctioning "sister-state preemption by exportation," the Congressional intent was that the federal rate specified in NBA Section 85 as the alternate to a borrowed state most-favored lender rate applies.[41]

As has been noted, the opt-out provisions

> only make sense based on an assumption that they were designed to give states control of the lending activities occurring within their borders, whether conducted by resident or out-of-state institutions. Section 525 allows states to override the federal preemption of state usury laws with respect to the inclusive class of 'Other Lonas.' If the opt-out right were only to affect in-state institutions, opt-out states would lose control of all out-of-state federally insured lenders that could simply export higher rates into the state. An opt-out would then serve only to create a lucrative market for out-of-state lenders by preventing in-state lenders from participation. Such a result makes no sense, especially in light of DIDA's designated purpose of eliminating institutionally based discrimination. However, by construing the effect of the opt-out as controlling all lending within a jurisdiction by federal insured state chartered institutions, no matter where located, ie by denying preemptive exportation authorizing effect, a rational scheme is discerned.[42]

Perhaps even more telling is an examination of the parallel opt-out provisions in a different part of DIDA. Statutory construction principles tell us that similar provisions in the same law are to be interpreted consistently. The first lien mortgage preemption provision in DIDA Title I Part applies except as to loans "<u>made in any State after the date"</u> on which the opt –out occurs. (12 U.S.C. Sec. 1735f-7a(b).) The DIDA Title I Part C opt-out says that the preemptive amendments, including what is now FDIA Section 27, only apply to loans "<u>made in any State</u>" before it opts-out. (Pub. L. 96-221, Sec. 525.) (emphasis added.)

To the best of our knowledge, there is no support for the proposition that the parallel opt-out right in DIDA Part A (first lien preemption) would permit state chartered institution based in a deregulated state to export its home state's mortgage law <u>into</u> one of the 16 states that opted-out of the DIDA first lien preemption.[43] It violates principles of

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41 Given the complete absence of reference to Marquette and exportation, and the short time between Marquette and this, there is considerable question as to whether interstate exportation, rather than intrastate distinctions, was the intent of DIDA § 521 at all. "Interstate lending was not an object of the legislation primarily because national banks had barely begun to realize the opportunities created by Marquette in the few months between that decision and the passage of DIDA." Robert A. Burgess and Monica A. Ciolfi, *Exportation or Exploitation? A State Regulators' View of Interstate Credit Card Transactions*, 42 Bus. Law. 929, 939 (1987). The reference to the alternate federal rate, rather than an "exported" rate bolsters that interpretation.

42 *Id* at 939-940.

43 Federal statutes other than FDIA § 27 or NBA § 27 may be invoked to do so. But resort to those alternative sources of preemption would not be necessary if DIDA's Part A's first lien opt-out were interpreted consistently with the proposed §331.5, its DIDA Part C parallel.

statutory construction to argue that the DIDA Title I, Part A opt-out does allow opting-out states to protect its citizens from sister state preemption, but that the comparable right – using the same language -- in DIDA Title I, Part C does not. Yet that is the position that the FDIC proposes to adopt with this rule. That is without either legal or policy foundation.[44]

Particularly in light of the oft-quoted legislative history of Riegle-Neal I which repeats the Congressional view that states have a "strong interest in the activities and operations of depository institutions doing business within their jurisdictions regardless of the type of charter the institution holds,"[45] we believe that the proposed rule would subvert clear and repeatedly expressed Congressional mandate.

This proposed reading, which would essentially render the opt-out a nullity, also is an interpretation of relatively recent origin, and the FDIC has itself not always been so parsimonious with the opt-out.[46] Here, too, it is one apparently adopted at the behest of industry. Specifically, it was advanced to the FDIC at the behest of a state bank engaged in activities which has attracted the attention of state attorneys general for a variety of its practices. As the boiler plate of many interstate lending operations shows, it is not uncommon to honor the laws of different states. Many state-chartered banks did consider Iowa's opt-out to require compliance with Iowa's credit laws for nearly two decades, as described by the 1987 article. But when a dispute arose with one bank, subsequently the target of investigations in several states for various practices, it urged the position articulated in this proposal on the FDIC.[47]

Should the agency proceed with rule-making, we urge that proposed § 331.5 be deleted in its entirety. But even if the rule-making does not proceed, we strongly encourage the board to make explicit the position that the effect of an opt-out under § 525 is that it control all lending within the opting-out jurisdiction by state-chartered institutions, irrespective of where they are located.

V. Conclusion

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[44] We note, too, that constitutional issues remain, as we discussed in our May 16 comments, (Comments of CRL, May 16, pg. 5-6.) While the supplementary information to the proposed rules dismiss them, we believe that this narrowing of the opt-out effect would instead highlight them.

[45] H.R. Conf. Rep. 103-651, at p. 53.

[46] Cf. FDIC-88-45 (Letter of Douglas H. Jones, June 29, 1988), rejecting the argument advanced by a bank that "only a bank's home state has any right to countermand the federal preemption with respect to loans made by that bank." That FDIC letter recognized that "Congress adopted section 525 in an effort to preserve principles of federalism. Recognizing that section 521 deprived states of authority over matters traditionally committed to State control, Congress enacted section 525 in order to enable states to recover authority that section 521 had taken away." It rejected the position that a loan was automatically "made" where the bank was located.

[47] Interestingly, it was the same law firm that represented Huntington Bank in seeking OCC interpretation # 822. (We do not have the exact date of the FDIC letter. However, one of the authors of these comments was a regulator in Iowa, and was involved in the correspondence between the bank , the state, and the FDIC.) The bank was Cross-Country Bank, which has been the subject of investigation and enforcement actions in at least half a dozen states.

We believe it is not necessary, and in fact ill-advised, for the FDIC to act now. Indeed, delay may be the most efficient and resource-sensitive action for both the agency and state banks. However CRL commends the FDIC on its willingness to begin the discussion around state bank parity issues, and we look forward to participating with the FDIC and other stakeholders as we continue to work towards a more detailed and comprehensive approach to the competing interests around interstate banking issues.

Respectfully submitted,

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