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Appeal No. 09-56679

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOSE AGUAYO, an individual,

Plaintiff-Appellant,

vs.

U.S. BANK, a business entity form unknown,
and DOES 1-30, inclusive,

Defendants-Appellees.

Appeal from the U.S. District Court for the Southern District of California
The Honorable Thomas J. Whelan Presiding

No. 08-cv-2139-W-BLM

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CORPORATE DISCLOSURE

U.S. Bank National Association is a wholly owned subsidiary of U.S. Bancorp, a publicly held corporation.

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JURISDICTIONAL STATEMENT

Appellee U.S. Bank National Association ("U.S. Bank") agrees with appellant's jurisdictional statement.

STATEMENT OF ISSUES

1. Do the National Bank Act and the implementing regulations of the Office of the Comptroller of the Currency preempt detailed and highly technical disclosure requirements imposed by California's Rees-Levering Motor Vehicle Sales and Finance Act ("Rees-Levering"), where such requirements are sought to be applied to a national bank seeking repayment of a secured debt that it purchased from another lender?

2. Is plaintiff's claim under the California Unfair Competition Law ("UCL"), Cal. Bus. & Prof. Code § 17200 *et seq.*, predicated on alleged violations of Rees-Levering and therefore federally preempted?

STATEMENT OF THE CASE

California imposes various state law requirements on lenders who finance the purchase of automobiles in California. Following a borrower's default, and the lender's repossession of the collateral securing the loan, Rees-Levering requires lenders to provide highly detailed disclosures before disposing of the collateral. In particular, Rees-Levering requires the lender to send a post-repossession Notice of Intent to Dispose of Vehicle by Sale providing specific information about what the borrower needs to do in order to cure the default and reinstate the contract. As one California court has summarized the disclosure requirements:

> [The notice must] provide a level of specificity as to the conditions precedent to reinstatement sufficient to inform the buyer—without need for further inquiry—as to exactly what the buyer must do to cure the default. Thus, [Rees-Levering] requires that a creditor inform the [borrower] of any amounts the [borrower] must pay to the creditor and/or to third parties, and provide the [borrower] with the names and addresses of those who are to be paid. The creditor must also inform the [borrower] regarding any additional monthly payments that will come due before the end of the notice period, as well as of any late fees, or other fees, the amount(s) of these additional payments or fees, and when the additional sums will become due.

Juarez v. Arcadia Fin., Ltd., 152 Cal. App. 4th 889, 904-05 (2007).

U.S. Bank is a national banking association with its main offices in the State of Ohio, organized and operating under the National Bank Act ("NBA"), and subject to primary oversight by the Office of the Comptroller of the Currency ("OCC"). (Appellee's Supplemental Excerpts of Record ("SER") 8-45.) The lending operations of U.S. Bank, are governed by federal law, generally to the exclusion of state law. *See Bank of Am. v. City & County of S.F.*, 309 F.3d 551, 561 (9th Cir. 2002). In particular, the NBA and its implementing OCC regulations preempt any use of state law to impair, prohibit, or condition a national bank's lending practices, including those concerning (i) notice and disclosure provisions, (ii) terms of credit, and (iii) security property. 12 C.F.R. § 7.4008.

This does not mean, as plaintiff suggests, that national banks have no obligation to provide any form of notice following repossession. National banks are, in general, subject to the uniform requirements of the Uniform Commercial Code ("UCC"). OCC Interpr. Letter No. 1005 (June 10, 2004), *available at* http://www.occ.treas.gov/interp/sep04/int1005.pdf. The uniform provisions of the UCC include provisions that address these circumstances. Those provisions, in contrast to Rees-Levering's detailed post-repossession notice requirements, require a lender to provide certain basic information following a repossession, such as the lender's telephone number and the borrower's right to obtain more information about the amount owed. UCC §§ 9-610(a), 9-614 & 9-615(d)(2).

On July 30, 2008, plaintiff Jose Aguayo filed a putative class action in California state court against U.S. Bank, complaining that the notice he received from the bank following repossession of his car did not comply with Rees-Levering's detailed requirements for post-repossession notices. (Appellant's Excerpts of Record ("ER") 57.) The complaint asserted causes of action for violation of Rees-Levering and a derivative violation of California's Unfair Competition Law, Cal. Bus. & Prof. Code § 17200 *et seq*., both based on the alleged defects in the post-repossession notice received by plaintiff. U.S. Bank timely removed the action to federal court on November 19, 2008, pursuant to the

Class Action Fairness Act. (ER 50.) U.S. Bank then moved to dismiss the complaint on the basis that federal law preempts plaintiff's claims.[1] (SER 1-7.)

On September 24, 2009, the district court granted U.S. Bank's motion to dismiss, holding that "the Rees-Levering Act is preempted by [OCC] regulation." (ER 14.) Judge Whelan noted that OCC regulations, specifically 12 C.F.R. § 7.4008(d)(2)(viii), expressly preempt any state law regulating "[d]isclosures and advertising, including laws requiring specific statements, information, or other content to be included in . . . credit-related documents." (ER 10-11.)

Judge Whelan further concluded that plaintiff could not avoid this express preemption by pointing to the fact that U.S. Bank had acquired the loan by assignment. (ER 14-16.) He reasoned that OCC regulations expressly authorize national banks to "purchase" loans from other sources, 12 C.F.R. § 7.4008(a), and that the OCC's interpretation of its own regulations requires that assigned loans be subject to the same preemption test as direct loans. (ER 15.) Under OCC regulations, "a national bank-owned [loan] is the equivalent of a national bank loan. Once purchased, a [loan acquired by assignment] is treated for regulatory

[1] U.S. Bank also moved to dismiss on the ground that Mr. Aguayo's claims failed as a matter of state law. The district court, however, did not rule on those issues because it found that federal law preempted Mr. Aguayo's claims.

and reporting purposes the same as a loan originated by the bank." (ER 15 (quoting OCC Interpr. Letter 1095 (Mar. 2008) at 3).)

Judge Whelan held that, because both claims in the complaint relied upon the allegation that U.S. Bank's post-repossession notice did not satisfy the requirements of Rees-Levering, both claims were preempted. (ER 16.) He concluded that "Aguayo's cause of action under California's Unfair Competition Law lacks a 'cognizable legal theory'" because that claim is based on the purported violation of a preempted law. (*Id.* (citation omitted).)

STATEMENT OF FACTS

Plaintiff purchased a vehicle from a dealership on or about August 10, 2003. (ER 47.)[2] The dealership assigned the conditional sale contract through which he financed the purchase to U.S. Bank. (ER 58 ¶ 6; ER 49.) The vehicle sale contract expressly provides that it is governed by "[f]ederal law and California law." (ER 48 ¶ 6.) Approximately four years after he purchased the vehicle, Plaintiff defaulted, and U.S. Bank repossessed the vehicle. (ER 58 ¶ 7.) The Complaint does not challenge the propriety of the repossession.

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[2] Although neither (1) the vehicle sale contract and assignment to U.S. Bank nor (2) the "notice of intent to dispose of repossessed vehicle" was attached to the Complaint, the district court properly considered both documents in ruling upon defendant's motion to dismiss because the Complaint cites their terms. *See Fecht v. Price Co.*, 70 F.3d 1078, 1080 n.1 (9th Cir. 1995).

Following the repossession, U.S. Bank sent plaintiff a notice of intent to dispose of the vehicle by sale, dated August 14, 2007, advising him that the vehicle had been repossessed and would be sold, and that he would be liable for any deficiency balance plus interest from the date of sale to the date of entry of judgment, unless he took certain actions. (ER 59 ¶ 8; ER 45.) Plaintiff's contract balance at the time was approximately $24,000. (ER 45.) The notice expressly warned plaintiff, in all-capital letters, that he "MAY BE SUBJECT TO SUIT AND LIABILITY IF THE AMOUNT OBTAINED UPON DISPOSITION OF THE VEHICLE IS INSUFFICIENT TO PAY THE CONTRACT BALANCE AND ANY OTHER AMOUNTS DUE." (*Id*.) Notwithstanding the notice, plaintiff failed to pay off the contract balance or bring his account current. As a result, U.S. Bank sold the vehicle and assessed a deficiency balance against plaintiff because the proceeds of the sale failed to cover his outstanding balance. (ER 59 ¶¶ 9-10.)

The Complaint arises from the post-repossession notice that U.S. Bank provided to plaintiff. (ER 43-45.) Plaintiff asserts that he had the right to reinstate the loan (ER 59 ¶ 9) and implicitly acknowledges that the notice in fact provided him that option and instructed him on how to obtain information about the "exact amount [he] must pay" to reinstate his loan (ER 43). He nonetheless claims the post-repossession notice was deficient because it did not, in a manner consistent with California law, "fully and properly set forth" the conditions precedent for reinstatement. (ER 59 ¶ 9.) The Complaint offers no further details regarding how the notice was purportedly deficient (e.g., what information was allegedly missing). Based on that solitary, conclusory allegation, plaintiff contends that U.S. Bank's assessment of a deficiency balance against him following the sale of the vehicle was wrongful. (ER 59 ¶ 10; ER 62 "Prayer" ¶ b.)

STANDARD OF REVIEW

Issues of statutory interpretation and preemption are reviewed de novo, *Silvas v. E*Trade Mortgage Corp*., 514 F.3d 1001, 1004 (9th Cir. 2008), as is the grant of a motion to dismiss for failure to state a claim. *Decker v. Advantage Fund Ltd*., 362 F.3d 593, 595-96 (9th Cir. 2004).

SUMMARY OF ARGUMENT

The National Bank Act grants national banks the power to lend money without regard to state law restrictions. 12 U.S.C. § 24 (Seventh). The OCC has determined that this grant of power under the NBA expressly preempts state law disclosure requirements, concluding that national banks' lending powers would be impermissibly burdened by requiring them to track and comply with different, often highly technical lending disclosure rules in every state. 12 C.F.R. § 7.4008(d)(2). Plaintiff's appellate brief does not dispute that Rees-Levering imposes precisely such highly technical disclosure requirements on post-repossession notices. Nor does plaintiff's appellate brief dispute that the NBA and its implementing OCC regulations preempt state law disclosure requirements.

Instead, plaintiff contends that his claim should escape preemption because post-repossession notices regulated by Rees-Levering are not "credit-related" and do not involve a bank's "lending powers." That is flatly wrong. Plaintiff's Complaint asserts that, unless U.S. Bank complies with Rees-Levering's highly technical disclosure requirements, the bank is barred from exercising its most fundamental right as a secured lender following plaintiff's contractual failure to repay his debt: the right to obtain repayment by seizing and selling the collateral and thereafter recovering from plaintiff the remaining balance on the debt. (ER 59 ¶ 10; ER 62 "Prayer" ¶ b.) As such, plaintiff's claims seek to directly constrain U.S. Bank's federally authorized lending powers.

Plaintiff protests that the constraint on U.S. Bank's lending powers occurs after the lending relationship has "ended" and has entered its "debt collection" phase. That argument fundamentally misunderstands Rees-Levering's notice requirements. Rees-Levering forces lenders to provide extensive notice regarding the borrower's right to redeem or reinstate an auto loan—that is, how the borrower can force the lender to *continue* a lending relationship after the borrower has defaulted and the lender would otherwise be entitled to call the loan immediately due and payable. The notice required by Rees-Levering concerns the continuation of a lending relationship, not its termination.

Unable to show that his claims survive federal preemption, plaintiff contends that U.S. Bank contractually "agreed" to comply with Rees-Levering. His sole support for this assertion is the fact that his retail installment contract requires the bank to provide all "notices required by law." It is axiomatic, though, that a notice is not "required by law" when the law requiring such notice is federally preempted.

Plaintiff argues that U.S. Bank must provide Rees-Levering notice because the bank acquired his loan by assignment from an automobile dealer who would otherwise have been subject to Rees-Levering. The OCC, however, has determined that a national bank has the power to acquire retail installment contracts by assignment, 12 C.F.R. § 7.4008(a), and that national banks possess the same powers for loans acquired by assignment as for loans originated by the bank itself. OCC Interpr. Letter No. 1095 (Feb. 27, 2008) at 3, *available at* http://www.occ.treas.gov/interp/mar08/int1095.pdf; OCC Interpr. Letter No. 416, 1988 WL 284802 (Feb. 16, 1988). That OCC determination, which is binding upon the courts, comports with the purpose of the NBA. Otherwise, national banks could acquire loans by assignment only if they monitored and complied with every state law governing those loans, thus defeating the purpose of national banking.

Plaintiff protests that U.S. Bank is an assignee, and thus cannot have more rights as to his loan than the assignor, a California car dealer subject to Rees-Levering. Although plaintiff is correct that an assignee generally cannot derive *from a contract* more rights than an assignor had, U.S. Bank's power to lend without regard to state law limitations does not derive from the assignment of any contract. U.S. Bank's federal lending powers come from the NBA.

In the end, plaintiff cannot escape the simple fact that federal law preempts the imposition of state-by-state disclosure requirements on loans held by national banks. Plaintiff enlists the support of *amici*, who argue that, as a matter of policy, they would prefer the application of state law. Those policy preferences, however, do not justify ignoring the preemptive force of federal law. The OCC's determinations are directly within the scope of the agency's authority, and as such, are binding on the courts. The courts may not substitute their own policy judgments for those of the agency. And, in any event, *amici's* principal concern—that lenders will not be required to provide post-repossession notices if Rees-Levering is preempted—is unfounded. The OCC has determined that the Uniform Commercial Code, which requires a uniform and streamlined form of post-repossession notice that applies in all fifty states, is not preempted as to national banks. *Amici's* dire warnings that national banks will operate in a "vacuum" if federal law applies are unwarranted. The district court's opinion should be affirmed.

ARGUMENT

I. THE NATIONAL BANK ACT AND GOVERNING OCC REGULATIONS PREEMPT THE APPLICATION OF REES-LEVERING'S DETAILED DISCLOSURE REQUIREMENTS TO NATIONAL BANKS SUCH AS U.S. BANK.

A. The District Court Properly Held that the Usual Presumption Against Preemption Does Not Apply in the Context of National Banking.

The federal government's role in regulating national banks is extensive and unique, and generally operates to the exclusion of state law. *See Bank of Am. v. City & County of S.F.*, 309 F.3d 551, 561 (9th Cir. 2002). "Nearly 200 years ago . . . [the Supreme] Court held federal law supreme over state law with respect to national banking." *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 10 (2007) (citing *McCulloch v. Maryland*, 17 U.S. 316 (1819)). "In 1864, Congress enacted the [National Bank Act], establishing the system of national banking still in place today." *Id*. (citations omitted). The purpose of that Act was to create a national banking system free from conflicting state regulation. *See Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314-15 (1978).

To further its vision of a federally regulated, national banking system, Congress also established the OCC, and charged it with implementing the NBA and regulating the national banks. *See NationsBank of N.C., N.A. v. Variable*

Annuity Life Ins. Co., 513 U.S. 251, 256-57 (1995). Congress granted the OCC comprehensive rulemaking authority to carry out its mission. *See* 12 U.S.C. § 93a ("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.").

"The supremacy of the federal government in regulating national banks has long been recognized." *Bank of Am.*, 309 F.3d at 561; *see also Marquette Nat'l Bank*, 439 U.S. at 308 (citation and quotations omitted) (national banks are "instrumentalit[ies] of the Federal government, created for a public purpose, and . . . subject to the paramount authority of the United States"). Through the NBA, Congress has authorized national banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 (Seventh). The Supreme Court has consistently recognized that this is a "grant[] of authority not normally limited by, but rather ordinarily pre-empting, contrary state law." *Barnett Bank, N.A. v. Nelson*, 517 U.S. 25, 32 (1996). "Where . . . Congress has explicitly granted a power to a national bank without any indication that Congress intended for that power to be subject to local restriction, Congress is presumed to have intended to preempt state laws." *Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1037 (9th Cir. 2008). So strong is the tenet that federal rather than state law should regulate national banks, "the usual presumption against federal preemption of state law is inapplicable to federal banking regulation." *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949, 956 (9th Cir. 2005).

Plaintiff contends that the Supreme Court's opinions in *Wyeth v. Levine*, 129 S. Ct. 1187 (2009), and *Cuomo v. The Clearing House Ass'n*, 129 S. Ct. 2710 (2009), have overruled *sub silentio* this longstanding line of precedents, such that the presumption against preemption now applies to national banking. (Appellant's Br. at 15, 21-22, 48 n.7.) That is incorrect.

Wyeth did not involve national banking. There, the Court addressed the history of overlapping federal and state regulation of drug safety. 129 S. Ct. at 1195-96. The Court emphasized that Congress did not give the Food and Drug Administration ("FDA") power to regulate drug safety until the 1960s, and that Congress did not grant the FDA power to regulate drug *labeling*, the issue in that case, until 2007. *Id.* Instead, Congress historically had left regulation of drug safety and labeling to the states. *Id.* Given the history of state regulation, the Court concluded that the presumption against preemption was inapplicable. *Id.* at 1195 n.3. Nothing in *Wyeth* alters the core precept that the business of national banking has historically been regulated by federal, not state, law.

Cuomo, the other case on which plaintiff relies, does not help him either. *Cuomo* addressed the scope of the OCC's "visitorial powers" under the NBA: that is, the OCC's exclusive power to examine national banks and the extent to which that power precludes state officials from investigating national banks for violations of federal laws or *non-preempted* state laws. 129 S. Ct. at 2718. *Cuomo* did not address the substantive scope of state laws preempted by the National Bank Act and OCC regulations. And, in any event, *Cuomo* did nothing to overturn the longstanding rule that no presumption against preemption applies in the context of national banking. In *Cuomo*, the majority opinion noted that the state enforcement of non-preempted state laws had "always" been part of "traditional state powers." 129 S. Ct. at 2720. Nonetheless, the majority opinion did not invoke a presumption against preemption. *Id.* ("We have not invoked the presumption against pre-emption . . . ."). Instead, the majority opinion noted the dissent's conclusion that "this case does not . . . prompt a presumption against preemption" because "federal involvement in this field dates to the earliest days of the Republic." *Id.* (citation omitted); *see also id.* at 2732 (citation omitted) (Thomas, J., dissenting, joined by Roberts, C.J., Kennedy, J., and Alito, J.) (the presumption against preemption is "not triggered when the State regulates in an area where there has been a history of significant federal presence," and "[n]ational banking is the paradigmatic example" of such presence). The majority opinion did not dispute that point, and emphasized that it had not relied upon any such presumption against preemption. *Id.* at 2720. Nowhere was *Wyeth* mentioned in either the majority or the dissenting opinions.

Plaintiff asserts that Ninth Circuit case law has applied a presumption against preemption in the context of national banking where "plaintiff's claim addressed an area traditionally left to state regulation." (Opp. at 22.) That, again, is wrong. "***Regardless of the nature of the state law claim alleged***, . . . the proper inquiry is whether the legal duty that is the predicate of Plaintiffs' state law claim falls within the preemptive power of the NBA or regulations promulgated thereunder." *Rose*, 513 F.3d at 1038 (emphasis added). Accordingly, the Ninth Circuit has repeatedly held that a presumption against preemption is inapplicable when evaluating the application to national banks of state consumer protection laws or state licensing requirements. *See id.* at 1037 (in evaluating a California UCL claim, holding that "the usual presumption against federal preemption of state law is inapplicable"); *Boutris*, 419 F.3d at 956 (holding same in evaluating California licensing laws).

B. OCC Regulations Expressly Preempt State Law Disclosure Requirements.

1. Rees-Levering's Notice Requirements Are Expressly Preempted by 12 C.F.R. § 7.4008(d)(2)(viii).

The NBA expressly grants national banks, like U.S. Bank, the authority to carry on "the business of banking," which includes "loaning money on personal security." 12 U.S.C. § 24 (Seventh). The OCC has determined that this lending function of national banks includes the purchase of retail installment sales contracts, such as auto loans. OCC Interpr. Letter No. 1095 at 3 ("A national bank owned RIC is the equivalent of a national bank loan."); OCC Interpr. Letter No. 416 (referring to motor vehicle retail installment sale contracts as "loan assets").

National banks may exercise their authorized powers free from state law restrictions: "where Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies." *Barnett Bank*, 517 U.S. at 34. Accordingly, the OCC has issued regulations clarifying that state laws that attempt to condition or regulate a national bank's lending operations are preempted. *See* 12 C.F.R. § 7.4008(d). The Supreme Court, in turn, has made it clear that courts must defer to these regulations: "The Comptroller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of [a rule of deference] with respect to his deliberative conclusions as to the meaning of these laws." *NationsBank*, 513 U.S. at 256-57 (quotation omitted).

As the OCC's regulations expressly provide, 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."

12 C.F.R. § 7.4008(d)(1). More specifically, section 7.4008(d)(2) enumerates examples of authorized lending activities to which state law cannot apply without of necessity interfering impermissibly with a national bank's lending powers. That list specifically singles out state-by-state disclosure requirements as interfering with a national bank's lending powers:

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

12 C.F.R. § 7.4008(d)(2) (emphasis added). That OCC regulation, whose authority plaintiff does not challenge, has the same preemptive force as a federal statute. *See Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) ("Federal regulations have no less pre-emptive effect than federal statutes."); *Bank of Am.*, 309 F.3d at 564 (holding that the NBA and OCC regulations "together preempt conflicting state limitations on the authority of national banks").

As the district court correctly held, section 7.4008(d)(2) expressly preempts Rees-Levering's imposition of additional disclosure requirements on post-repossession notices. "The Rees-Levering post-repossession notice standards are undoubtedly disclosure requirements." (ER 10.) As interpreted by the California state courts, Rees-Levering requires banks to include highly specific information on post-repossession notices, including (a) the names and addresses of the creditor and all third parties to whom the borrower owes payment, (b) the exact amount due, including amounts of additional monthly payments that will come due or become due after the notice is issued but before the end of the notice period, and (c) the exact amounts of late fees and other fees, such as collection fees, that will come due or become due after the notice is issued but before the end of the notice period, and the date on which those payments will come due or become due. *Juarez v. Arcadia Fin., Ltd.*, 152 Cal. App. 4th 889, 904-05 (2007). The statute specifies the content of post-repossession notices down to the minutest details, including requirements that certain language be in "at least 10-point bold type" and that customers be told that a request for a written accounting of amounts due must be "personally served or sent first-class mail, postage prepaid, or certified mail, return receipt requested." Cal. Civ. Code § 2983.2. Under Rees-Levering, the failure to include those detailed disclosures in the post-repossession notice *completely eliminates* a creditor's right to recover the outstanding contract balance following the sale of the lawfully repossessed security. Cal. Civ. Code §§ 2983.2 & 2983.8.

The Ninth Circuit has repeatedly held that federal law preempts the application of such detailed state law disclosure requirements to national banks. In *Rose*, 513 F.3d 1032, for example, the Ninth Circuit held that the plaintiff's claims against a national bank for failure to comply with California statutory requirements regarding disclosures on "convenience checks" were preempted. The court explained that Congress had authorized national banks to loan money, and that "[w]here, as here, Congress has explicitly granted a power to a national bank without any indication that Congress intended for that power to be subject to local restriction, Congress is presumed to have intended to preempt state laws" that impose disclosure requirements purporting to limit that federally granted power. *Id.* at 1037. The court concluded that the state statute was expressly preempted by the NBA. *Id*. at 1036.

Similarly, in *Martinez v. Wells Fargo Home Mortgage, Inc*., 598 F.3d 549 (9th Cir. 2010), the plaintiffs alleged, among other things, that a national bank engaged in "fraudulent" conduct under the California UCL by failing to disclose information about its service fees. *Id.* at 556-67. The Ninth Circuit held that the National Bank Act preempted any such claim, because an OCC "regulation expressly authorizes banks to 'make real estate loans . . . without regard to state law limitations concerning . . . [d]isclosure and advertising, including laws requiring specific statements, information, or other content to be included in [credit-related documents].'" *Id.* (alterations in original). In *Martinez*, the Ninth Circuit was analyzing a parallel OCC regulation, 12 C.F.R. § 34.4(a), which applies to real estate loans, rather than section 7.4008. But the same logic applies to section 7.4008, which has the same operative language regarding preemption of state law disclosure requirements. *Compare* 12 C.F.R. § 34.4(a)(9) *with* 12 C.F.R. § 7.4008(d)(2)(viii).

2. Plaintiff's Argument that the Post-Repossession Notice Is Not a "Credit-Related Document" Is Unavailing.

Plaintiff's brief does not contest that Rees-Levering imposes disclosure requirements, or that section 7.4008(d)(2)(viii) expressly preempts the application of state law disclosure requirements to national banks. Instead, plaintiff's brief argues that post-repossession notices are not "credit-related documents." (Appellant's Br. at 43.)

Section 7.4008(d)(2)(viii), however, does not limit preemption of state law disclosure requirements to "credit-related documents." Rather, that section provides that national banks may make loans "without regard to state law limitations concerning . . . [d]isclosure and advertising, ***including*** laws requiring specific statements, information, or other content to be included in . . . credit-related documents." 12 C.F.R. § 7.4008(d)(2). "In construing a statute, the use of a form of the word 'include' is significant, and generally thought to imply that terms listed immediately afterwards are an inexhaustive list of examples, rather than a bounded set of applicable items." *United States v. Ledlin (In re Mark Anthony Constr.)*, 886 F.2d 1101, 1106 (9th Cir. 1989). A state law requiring credit-related documents to contain specific information is simply one example of a preempted disclosure requirement.

Furthermore, even if section 7.4008 were limited to credit-related documents, a post-repossession notice is such a document. As explained by the district court, "the purpose of such notice is to notify a debtor that his or her *credit* was revoked and that the collateral with which the debtor secured the *credit* is being sold, as well as to inform the debtor what he or she needs to pay in order to restore his or her *credit*." (ER 11 (citation omitted).) In so holding, the district court cited *Crespo v. WFS Financial Inc.*, 580 F. Supp. 2d 614 (N.D. Ohio 2008). In *Crespo*, the court was applying an analogous regulation issued by the Office of Thrift Supervision ("OTS") and containing the same language preempting state law requirements of "[d]isclosure and advertising, including laws requiring specific statements, information, or other content to be included in . . . credit-related documents." *Id.* at 618-19 (citing 12 C.F.R. § 560.2(b)).[3] There, the court

[3] Plaintiff criticizes the district court's citation to *Crespo* because that case involved an OTS regulation rather than an OCC regulation. (Appellant's Br. at 45-46.) The OTS, he notes, regulates federal thrifts, not national banks, and implements a statute that occupies the entire field. (*Id.*) Plaintiff does not explain, however, why "credit" should have a different meaning for a federal thrift than for a national bank, or why the existence of field preemption would affect the meaning of the term "credit."

held that a post-repossession notice was a "credit-related document" and, hence, that an Ohio law regulating the content of such notices was federally preempted.

Plaintiff's principal response is to argue that the post-repossession notice is not related to credit because it occurs "only after default and the parties' credit relationship has broken down." (Appellant's Brief at 44.) That is not accurate. The entire point of Rees-Levering is to allow a credit relationship to continue after repossession. Rees-Levering affords borrowers the right to pay certain amounts to "reinstate" the contract after default and repossession and thereby to require the bank to continue the credit relationship. Cal. Civ. Code § 2983.3(b). In imposing detailed disclosure requirements for post-repossession notices, "the [California] Legislature intended that creditors provide sufficient information to defaulting buyers to enable them to determine precisely what they must do in order to reinstate their contracts." *Juarez*, 152 Cal. App. 4th at 899. Accordingly, the post-repossession notice does not come at the end of the credit relationship, but rather states the terms on which the credit relationship may continue if the borrower chooses. *Id.*

Unable to explain why a notice about how to reinstate a credit relationship is not a "credit-related document," plaintiff falls back on arguing that the Uniform Commercial Code imposes disclosure obligations on national banks issuing post-repossession notices. (Appellant's Br. at 45.) If the UCC can impose such disclosure obligations, he reasons, the OCC must have declared open season on post-repossession notices, such that states can impose on national banks unlimited additional disclosure requirements. (*Id.*) In fact, the OCC interpretive letter on which plaintiff relies directly refutes his argument. That letter states that UCC provisions are not preempted because they impose a "*uniform* law of general applicability." OCC Interpr. Letter No. 1005 (June 10, 2004) at 2 (emphasis added). The letter warns that it is limited to the *uniform* provisions of the UCC and does not apply to state-specific disclosure requirements. "Your letter asks us to address the UCC sponsored by the NCCUSL and the ALI, which has been the law in every state for some 50 years. We are not undertaking to address non-uniform provisions that individual states may adopt . . . ." *Id.* at 1 n.3. Nothing in that opinion undercuts section 7.4008's express preemption of state-specific disclosure laws like Rees-Levering.

C. OCC Regulations Also Expressly Preempt State Law Restrictions on the Terms of Credit in Loans Held by National Banks and on Security Property Held by National Banks.

In addition, even ignoring section 7.4008's express preemption of state law disclosure requirements, plaintiff's claims are independently preempted under two other provisions of section 7.4008. Section 7.4008(d)(2) preempts state law restrictions on:

> (iv) ***The terms of credit***, . . . 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; [and]
>
> (vi) ***Security*** property, including leaseholds.

12 C.F.R. § 7.4008(d)(2). Rees-Levering's notice requirements run afoul of both those provisions.

There is no more fundamental "term of credit" than the right to obtain repayment of money lent. Application of Rees-Levering, however, would add a term of credit by layering state-imposed requirements upon that right: specifically, as the Complaint expressly pleads, a lender's right to recover a deficiency balance would be conditioned upon compliance with Rees-Levering. (ER 59 ¶¶ 9-10.) With few exceptions, Rees-Levering requires that a creditor allow the borrower, or any other person liable on the contract, to reinstate the contract after default and repossession and prohibits the creditor from accelerating the maturity date on any part of the contract until the expiration of the reinstatement period. Cal. Civ. Code § 2983.3(b). By creating a conditional right of reinstatement, Rees-Levering purports to force a national bank to give a borrower who has defaulted the option to continue a credit relationship under circumstances where the bank would otherwise be entitled to call the loan immediately due and payable. Rees-Levering thus profoundly impacts the fundamental terms of credit of the relationship and significantly interferes with a national bank's lending operations.

In addition, the application of Rees-Levering's post-repossession notice requirements interferes with a lender's interest in "security property" by restricting a national bank's ability to foreclose upon and sell the security property (i.e., the vehicle), credit the borrower's account with the sale proceeds, and then obtain repayment of the deficiency balance remaining on the contract. Section 7.4008(d)(2)(vi) thus independently preempts application of Rees-Levering.

Because the district court held that section 7.4008(d)(2)(viii) concerning "disclosures" expressly preempted plaintiff's claims, the court did not reach the preemptive effect of section 7.4008(d)(2)(iv) and (vi). However, both those issues, which U.S. Bank raised in its motion to dismiss (SER 1-7), provide further alternative grounds for affirmance of the district court's opinion. *Rivero v. City & County of S.F.*, 316 F.3d 857, 862 (9th Cir. 2002).

D. Contrary to Plaintiff's Argument, Rees-Levering's Notice Requirements Directly Affect U.S. Bank's "Lending" Operations.

Plaintiff asserts that Rees-Levering's notice requirements should survive preemption because they "do not interfere with bank lending." (Appellant's Br. at 39-43.) However, plaintiff concedes, as he must, that the "terms of credit" are an element of lending. (Appellant's Br. at 41.) As explained above, Rees-Levering purports to insert a new "term of credit" by conditioning the bank's most fundamental right as a lender: the ability to obtain repayment and call due a loan upon the borrower's default. As the district court properly held, "The federal banking powers extend to not only creating loans, but also purchasing, participating in, and dealing loans. The power to collect debts and repossess collateral property under default is inseparable from the power to make or purchase loans . . . ." (ER 12 (citation omitted).)

The court in *Abel v. KeyBank USA, N.A.*, 313 F. Supp. 2d 720 (N.D. Ohio 2004), reached a similar conclusion, holding that the NBA and section 7.4008 preempted certain provisions of Ohio's Retail Installment Sales Act that purported to restrict a national bank's ability to collect on outstanding balances. The court explained that this type of state regulation "significantly interferes" with a national bank's ability to carry out its lending powers, and that the state law was prohibited by section 7.4008(d)(2)(iv), which "indicates that national banks may lend money without regard to state laws imposing requirements as to the terms of credit." *Id.* at 727-28.

Relying on a district court opinion in *Alkan v. Citimortgage, Inc.*, 336 F. Supp. 2d 1061 (N.D. Cal. 2004), plaintiff responds that Rees-Levering is a "debt collection" statute and thus cannot be preempted. (Appellant's Br. at 39-43.) But *Alkan* involved a claim under California's Rosenthal Fair Debt Collection Practices Act ("Rosenthal Act"), the provisions of which are fundamentally different from Rees-Levering's. The Rosenthal Act regulates the *manner* of debt collection, including prohibitions on harassing phone calls, obscene language, and threatening letters. 336 F. Supp. 2d at 1064 (citing Cal. Civ. Code §§ 1788.10 & 1788.11). By contrast, Rees-Levering directly targets the lending operations of U.S. Bank, purporting to specifically condition the exercise of U.S. Bank's rights.

Plaintiff insists, however, that Rees-Levering has some effect on debt collection and that no statute that affects debt collection could possibly affect "lending." (Appellant's Br. at 39-42.) Although plaintiff points to a "distinction" in section 7.4008 and the case law between debt collection and lending, he offers no support for his odd conclusion that "lending" and "debt collection" are mutually exclusive categories. (*Id.*)

Indeed, section 7.4008's savings clause, on which plaintiff relies, disproves his argument. The savings clause provides that certain debt collection laws survive conflict preemption, so long as they "only incidentally affect the exercise of national banks' non-real estate lending powers." 12 C.F.R. § 7.4008(e). But, if debt collection activities could never be part of a national bank's lending powers, as plaintiff asserts, there would be no need for a savings clause. Under plaintiff's tortured definition of "lending," there would be nothing to save, because debt collection activities would already be excluded from a national bank's lending powers.

Moreover, plaintiff's odd interpretation renders meaningless the saving clause's provision that debt collection laws remain preempted if they have more than an incidental effect on lending. If debt collection can never affect lending, as plaintiff argues, that language would be mere surplusage. *Am. Vantage Cos. v. Table Mountain Rancheria*, 292 F.3d 1091, 1098 (9th Cir. 2002) (citation and internal quotations omitted) ("It is a well-established principle of statutory construction that legislative enactments should not be construed to render their provisions mere surplusage.").

Plaintiff's contorted reading of section 7.4008 cannot save his claims from preemption. Rees-Levering purports to restrict a national bank's power to loan money by placing conditions on the most fundamental aspect of lending: the bank's right to be repaid.

E. Section 7.4008's Savings Clause Does Not Revive Plaintiff's Claims.

1. The Savings Clause Does Not Apply to Claims That Are Expressly Preempted.

Plaintiff attempts to rescue his case by pointing to section 7.4008(e)'s "savings clause." That clause, however, is inapplicable here because plaintiff's claims are expressly preempted.

Section 7.4008 provides for both express preemption and conflict preemption. Section 7.4008(d)(2) expressly preempts certain categories of state laws and authorizes national banks to act "without regard to state law limitations" in those areas. Meanwhile, section 7.4008(d)(1) provides for conflict preemption of state laws that "obstruct, impair, or condition" national banking powers. A savings clause limits the scope of such conflict preemption: "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: . . . Rights to collect debts." 12 C.F.R. § 7.4008(e) (emphasis added).

That savings clause applies only to conflict preemption. Where, as here, a state law falls under a category *expressly* preempted by subdivision (d)(2) of the regulation (e.g., laws mandating specific disclosures in lending), then the preemption inquiry is complete, and any exclusions set forth in subdivision (e) are irrelevant to the analysis. *See O'Donnell v. Bank of Am., N.A.*, No. C-07-04500 RMW, 2010 U.S. Dist. LEXIS 23641, at *12-13 (N.D. Cal. Mar. 15, 2010) (construing a parallel OCC regulation applicable to real estate lending, 12 C.F.R. § 34.4(a)). As the district court explained, laws are listed as expressly preempted in section 7.4008(d)(2) because the OCC determined that those types of laws directly conflict with national banking powers. (ER 10.) *See Rose v. Chase Manhattan Bank USA, N.A.*, 396 F. Supp. 2d 1116, 1121 (C.D. Cal. 2005) ("[T]he OCC can determine which types of state laws 'obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized non-real estate lending powers,' and it did just that when it enacted subsection (d)(2)."), *aff'd*, 513 F.3d 1032, 1037 (9th Cir. 2008). As such, those categories of state laws have more than an "incidental effect" on a national bank's exercise of its lending powers, and the savings clause, by its own terms, would not apply. 12 C.F.R. § 7.4008(e) (savings clause does not apply to laws that more than "incidentally affect" national banking powers).

The Office of Thrift Supervision has provided guidance on this precise issue, in construing an analogous OTS regulation. The OTS has issued federal preemption regulations under the Home Owner's Loan Act ("HOLA") that are virtually identical to the OCC's preemption regulations under the NBA. *Compare* 12 C.F.R. § 560.2 *with* 12 C.F.R. § 7.4008. Both regulations contain a list of state laws that are expressly preempted, a provision for conflict preemption, and a savings clause that lists various categories of state laws that are not preempted. *Id.* The two lists of state laws that are expressly preempted, and of those that are saved, are virtually identical. *Id.* The OTS's regulatory guidance accompanying section 560.2 outlines the proper method for conducting the preemption analysis under that regulation:

> [T]he first step will be to determine whether the type of law in question is listed in paragraph (b) [outlining categories of express preemption]. If so, ***the analysis will end there***; the law is preempted.

61 Fed. Reg. 50951, 50966 (Sept. 30, 1996) (emphasis added). The savings clause is to be considered only if the state law does not fit in the list of laws expressly preempted. *Id.* The Ninth Circuit recently applied this analysis in *Silvas v. E*Trade Mortgage Corp.*, 514 F.3d 1001 (9th Cir. 2008). There, the court held that the OTS's preemption regulation expressly preempted a California UCL claim seeking to regulate disclosures and advertising by a federal thrift. *Id.* at 1006. In so holding, the court specifically declined to apply the savings clause, concluding that the "preemption analysis ends" because the state law claim "falls within the specific type of law listed" as expressly preempted. *Id.*

As the district court held, the same logic applies to the OCC's regulation here. (ER 13.) The relevant OCC and OTS regulations are virtually identical, and both have the goal of defining the scope of federal preemption in regulating the lending activities of federally chartered banks. Moreover, the OCC has made clear that it intended section 7.4008 to have the same preemptive scope as the companion OTS regulation. The OCC stated in promulgating section 7.4008 that "[t]he 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." 69 Fed. Reg. 1904, 1912 n. 62 (Jan. 13, 2004) (emphasis added). The OCC's interpretation of its own regulation is binding on the courts. *Silvas*, 514 F.3d at 1005 n.1.

Plaintiff protests that the courts should nonetheless ignore the OCC's binding guidance, and adopt a standard different from the one used by the OTS, despite the OCC's statement that the two regulations should be interpreted consistently. (Appellant's Br. at 51-52.) Plaintiff argues that the OTS preemption regulation, though virtually identical to the OCC one, has a broader scope because the "OTS, unlike the OCC, has occupied its entire field of regulation." (*Id.* at 51.) That, however, is irrelevant. The issue here is the scope of *express* preemption: that is, whether the savings clause applies where a state law falls within the categories of laws expressly preempted. Whether a statute occupies the field is relevant only to the scope of *implied* preemption, not to the scope of express preemption. *See Montalvo v. Spirit Airlines*, 508 F.3d 464, 470 (9th Cir. 2007); *see also* 69 Fed. Reg. at 1910-11 (OCC's statement that, in promulgating section 7.4008, whether the regulation occupies the field of lending "is largely immaterial" to its application). Plaintiff offers no principled reason why the OCC's regulation should be interpreted any differently from the OTS's for purposes of express preemption.

2. Even if the Savings Clause Applied, It Would Not Save Plaintiff's Claims Because Rees-Levering More than "Incidentally" Affects U.S. Bank's Lending Operations.

The district court correctly concluded that the savings clause, even if applicable, would not revive plaintiff's claims because Rees-Levering significantly interferes with U.S. Bank's lending operations. (ER 13.) Section 7.4008(e)'s savings clause provides that only those state laws of general applicability that "form the legal infrastructure that supports the conduct of commercial business operations . . . apply to national banks, unless they curtail or hamper the exercise of a national bank's powers." OCC Interpr. Letter No. 1082 (May 17, 2007) at 6, *available at* http://www.occ.treas.gov/interp/jun07/int1082.pdf. Stated differently, "[t]he commercial law framework essential for conducting any business, including the business of banking, continues to apply to the operations of national banks." *Id.* at 6 n.12. Rees-Levering, however, is not a law of general applicability concerning contracts or the right to collect debts, but rather is a state vehicle-financing regulation purporting to regulate national banks' lending authority. It singles out a specific form of lending—that is, car loans—and imposes highly technical state law disclosure requirements on those loans. Cal. Civ. Code § 2983.2. It cannot be saved by section 7.4008(e).

State laws that more than "incidentally" affect the lending operations of a national bank remain preempted even when the "savings clause" applies.

12 C.F.R. § 7.4008(e). Rees-Levering's effect on lending is far more than "incidental," as illustrated by the fact that plaintiff is invoking the law to avoid repayment of an otherwise valid debt, which affects the very core of U.S. Bank's lending operations. Because Rees-Levering purports to preclude U.S. Bank from obtaining any repayment if U.S. Bank does not strictly comply with its highly technical disclosure requirements, it more than "incidentally" affects U.S. Bank's lending operations and thus could not be "saved" by section 7.4008(e). *See Abel*, 313 F. Supp. 2d at 728.

Plaintiff argues that Rees-Levering's notice requirements "do not discriminate against banks," but apply to all lenders who finance automobile loans. (Appellant's Br. at 49.) That argument fundamentally misunderstands the nature of National Bank Act preemption. A state law is preempted if it significantly interferes with a national bank's lending powers, regardless of whether that state law happens to be applicable to other types of businesses. For example, in *Rose v. Chase Bank*, the Ninth Circuit held that the plaintiff's California UCL claim was federally preempted because it sought to impose duties that interfered with a national bank's lending powers, regardless of the fact that the UCL applies to all businesses, not just banks. 513 F.3d at 1038; *see also Martinez v. Wells Fargo Home Mortgage, Inc.*, 598 F.3d 549, 558 (9th Cir. Mar. 9, 2010) (holding that the

National Bank Act and OCC regulations preempted California UCL claim). The issue is whether the law targets lending, not whether it singles out national banks.

Indeed, *McClellan v. Chipman*, 164 U.S. 347 (1896), upon which plaintiff relies, demonstrates this precise point. There, the state law at issue placed restrictions on real estate transfers during insolvency. *Id.* at 358. In holding that the state law was not preempted, the Court emphasized that the restriction did not target lending but applied to all conveyances of real estate, whether in the context of a loan or not. *Id.* By contrast, the Court noted, a state law that targeted lending by, for example, barring all loans secured on real estate would be preempted. *Id.* at 358-59. Here, Rees-Levering specifically targets loans that finance the purchase of vehicles and conditions the lender's most fundamental right, that of repayment, upon compliance with a state statute's highly technical disclosure provisions.

F. The UCC Does Not Offer an End-Run Around Preemption of Plaintiff's Claims Either.

Plaintiff contends in the "Background" section of his brief that "a creditor like U.S. Bank cannot comply with the UCC unless it also complies with Rees-Levering's requirements." (Appellant's Br. at 13.) That argument misunderstands California Commercial Code section 9201, upon which plaintiff relies. Although section 9201(b) lists Rees-Levering as one of eight statutory schemes that may also apply to transactions governed by the Code, subsection (d)(2) expressly provides that it "does not . . . [e]xtend the application of [a] statute . . . to a transaction not otherwise subject to it." Cal. Com. Code § 9201(d)(2). In other words, the California Commercial Code does not render applicable those state laws listed in subdivision (b) that otherwise do not apply. Here, Rees-Levering's notice requirements do not apply to U.S. Bank because federal law preempts them. The UCC and the California Commercial Code do not offer an end-run around that preemption.

Moreover, even if the California Commercial Code did incorporate Rees-Levering in the manner plaintiff suggests, the application of Rees-Levering to U.S. Bank would still be preempted. The OCC determined that "uniform" provisions of the UCC are not preempted as applied to national banks, but declined to extend that determination to non-uniform provisions added to the UCC by individual states. OCC Interpr. Letter No. 1005 (June 10, 2004). To the extent the California Code has adopted the UCC's standard post-repossession notice provisions — which are adopted by other states too and advance the NBA's goal of uniformity — those are not preempted. Rees-Levering, however, is not a uniform provision that "has been the law in every state for some 50 years." OCC Interpr. Letter No. 1005 at n.2. Rather, Rees-Levering imposes California-specific requirements. Accordingly, it remains preempted. Case law confirms this point. The Ninth Circuit has repeatedly held statutes listed in California Commercial Code section 9201 to be preempted when applied to constrain national banking powers.

See, e.g., Cal. Com. Code § 9201(b) (listing the UCL); *Martinez*, 598 F.3d at 558 (holding UCL claim preempted under the National Bank Act); *Rose*, 513 F.3d at 1037-38 (same).

II. PLAINTIFF CANNOT ESCAPE PREEMPTION OF HIS CLAIMS ON THE BASIS THAT U.S. BANK ACQUIRED HIS CONTRACT BY ASSIGNMENT.

A. Nothing in Plaintiff's Contract with U.S. Bank Requires the Bank to Comply with a Preempted State Law Such as Rees-Levering.

Unable to escape preemption, plaintiff falls back on arguing that U.S. Bank voluntarily agreed to exempt itself from the broad scope of federal preemption of state laws that purport to interfere with its lending activities as a national bank. (Appellant's Br. at 24-27.) That is wishful thinking.

The Complaint does not allege that U.S. Bank *expressly* agreed to be bound by Rees-Levering's post-repossession notice requirements. Nor could it. There is no reference to Rees-Levering in the vehicle sale contract and assignment to U.S. Bank. (*See* ER 43-49.)

Instead, plaintiff relies on a provision of his retail installment contract stating that the lender will "provide . . . all notices required by law to tell [plaintiff] when and how much to pay and/or what action the plaintiff must take to redeem the vehicle." (ER 49 ¶ 3.e.) It is axiomatic, however, that a particular notice is *not* "required by law" where it is set forth in a state law whose application to U.S.

Bank is expressly preempted by federal law. Plaintiff cannot revive his claims by relying on such circular logic.

Plaintiff argues that the meaning of the phrase "all notices required by law" must be construed as of the time the contracts were entered into. (Appellant's Br. at 26.) From this, plaintiff concludes that the language must have "meant all notices that would be required of a California car dealer under California law," and that any holder must comply with Rees-Levering regardless of the circumstances at the time of repossession. (*Id*. at 27.) That makes no sense. By plaintiff's logic, if he had moved to another state after purchasing his vehicle, the holder of the contracts nonetheless would have to provide post-repossession notices that complied with California's Rees-Levering because that requirement was fixed when the contracts were entered. Similarly, under plaintiff's construction, a holder would have to comply with those provisions of Rees-Levering that were in effect when the contract was entered into, even if at the time of the repossession the provisions had changed or Rees-Levering no longer even required notices.

Nothing in the contractual language supports such an absurd result. By its plain language, "notice required by law" is just that: whatever notice the lender is required to provide by law. Indeed, if plaintiff had entered into his contract with U.S. Bank, and U.S. Bank subsequently assigned his contract to a California corporation not entitled to federal preemption, he would presumably expect the assignee to comply with Rees-Levering's notice provisions.

Plaintiff's sole support for his unusual contractual interpretation is that preemption here would render the contract's provision on notices "required by law" mere surplusage. (Appellant's Br. at 26.) As discussed below in section IV.B, the UCC contains post-repossession notice requirements, and U.S. Bank complies with those requirements. Accordingly, plaintiff's contention that the vehicle sale contract's reference to "notices required by law" must refer to Rees-Levering is baseless.

Indeed, it is *plaintiff's* interpretation, not U.S. Bank's, that renders language in the contract superfluous. The contract here expressly contemplated that the dealership would assign the loan to a financial institution, and provided that federal law, plus any applicable California law, governed the contract. (ER 48 ¶ 6; ER 49 ¶ a.) Plaintiff's contention that the contract's notice provision *must have* incorporated Rees-Levering would render meaningless the contract's express statement that "federal" law applies to it. If the contract required any subsequent holder of the loan to be subject solely to those laws applicable to the original lender, a California car dealer, then there would be no need to refer to "federal" law. Plaintiff cannot avoid preemption with his contorted reading of the contract.

B. That U.S. Bank Has a Contract with Mr. Aguayo Through an Assignment, Rather than Through a Loan Originated by the Bank, Is Irrelevant to the Preemption Analysis.

OCC regulations make it clear that a national bank does not assume otherwise preempted state law obligations merely because it acquires a retail installment sale contract by assignment, rather than by originating the loan itself. National banks are authorized to engage in activities that are part of, or incidental to, the business of banking, which includes "negotiating promissory notes" and "loaning money on personal security." 12 U.S.C. § 24 (Seventh). OCC regulations clarify that national banks are expressly authorized to purchase non-real estate loans originated by another entity. 12 C.F.R. § 7.4008(a). In interpreting that regulation, the OCC has determined that a retail installment sale contract, when owned by a national bank, is the equivalent of a national bank loan and is treated as such for regulatory purposes. OCC Interpr. Letter No. 1095 (Feb. 27, 2008) at 3; OCC Interpr. Letter No. 416 (Feb. 16, 1988) (referring to motor vehicle retail installment sale contracts as "loan assets"). The OCC's interpretation of its own regulation is binding on the courts. *See Auer v. Robbins*, 519 U.S. 452, 461 (1997) (agency interpretation of its own regulation is "controlling unless plainly erroneous or inconsistent with the regulation").

The OCC's controlling interpretation fits squarely with the purpose of national banking. The ability of national banks to exercise their express power to purchase non-real estate loans, including retail installment sale contracts, would be significantly impaired if they had to comply with state disclosure laws, such as Rees-Levering, that purport to restrict a bank's ability to foreclose upon and sell collateral. As the Supreme Court and the OCC have expressly recognized, section 7.4008 was promulgated, in part, because:

> [t]he application of multiple, often unpredictable, different state or local restrictions and requirements prevents [national banks] 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.

Watters v. Wachovia Bank, N.A., 550 U.S. 1, 22 n.6 (2007) (quoting 69 Fed. Reg. 1904, 1908 (2004)).

If the mere assignment of the contract to U.S. Bank rendered U.S. Bank, a national bank, subject to Rees-Levering's post-repossession notice requirements, then by implication U.S. Bank would be obligated to ascertain, monitor, and comply with the disparate laws of all fifty states regarding the repossession and sale of collateral in order to exercise its federally granted lending powers. *Compare* Cal. Civ. Code § 2983.2(a) (requiring fifteen day's notice of intent to sell collateral) *with* Ohio Rev. Code Ann. § 1317.16(B) (requiring ten day's notice of intent to sell collateral); *compare* Cal. Civ. Code § 2983.2(b) (requiring an accounting of the disposition of sale proceeds only upon debtor's request) *with*

Conn. Gen. Stat. 36a-785(e) (requiring an accounting within thirty days of resale); *compare* Cal. Civ. Code § 2983.2(a)(3) (providing for ten-day extension of the reinstatement or redemption period upon debtor's request) *with* Ohio Rev. Code Ann. § 1317.16(B) (no provision for extension of time to reinstate or redeem). But the NBA and OCC regulations were designed to avoid precisely such a hodgepodge of inconsistent state regulation. *See Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003) ("Uniform rules limiting the liability of national banks . . . are an integral part of a banking system that needed protection from 'possible unfriendly State legislation.'") (citation and internal quotations omitted).

Plaintiff contends that U.S. Bank assumed the obligation to comply with a preempted state law because "an assignor cannot assign more rights than it has under an agreement" and the assignor here would have been required to comply with the preempted law. (Appellant's Br. at 28.) Plaintiff's argument, however, confuses the issue. U.S. Bank's power to act without regard to state law limitations on disclosures is not based on plaintiff's contract. That power comes from the National Bank Act. Accordingly, it is irrelevant whether the assignor of the contract, Star Ford, would have had to comply with Rees-Levering. Imagine, for example, that a company has a license from federal regulators to broadcast television shows in the United States, and acquires by assignment the rights to a television show from a broadcaster in another country. It is self-evident that the company could broadcast the show in the United States even though the assignor (the foreign broadcaster) would have been barred from doing so. That is because the assignee's power to act derives not from the assignment of the contract but from federal regulation. The same is true here: U.S. Bank's national banking powers, upon which preemption of Rees-Levering is based, do not derive from the assignment of the contract, but from federal law and regulation.

None of the cases cited by plaintiff deals with a situation in which the assignor's actions are authorized by something other than the contract itself. *See Gen. Motors Acceptance Corp. v. Kyle*, 351 P.2d 768, 775 (Cal. 1960) (where conditional sale contract failed to include information required by Rees-Levering and the contract was thus illegal at inception, buyer was entitled to rescission against seller's assignee); *Essex Ins. Co. v. Five Star Dye House, Inc.*, 137 P.2d 192 (Cal. 2006) (evaluating assignability of tort damages for economic loss); *In re Doctors Hosp. of Hyde Park, Inc.*, 337 F.3d 951, 957 (7th Cir. 2003) (considering whether state is entitled to set-off where hospital owed it taxes and it owed hospital accounts receivable for services where the accounts receivable were assigned to a third party for collection).

C. The FTC Holder Rule Does Not Impose Upon U.S. Bank a Duty to Comply with Preempted State Laws.

In a last-ditch effort to avoid preemption, plaintiff argues that the FTC holder rule, 16 C.F.R. § 433.2, imposes upon U.S. Bank an obligation to comply with otherwise preempted state law. The FTC holder rule was intended to subject the assignee of a retail credit sale contract to all of the claims and defenses that could have been asserted against the original seller. *See* 16 C.F.R. § 433.2. This is, in fact, how the plain language of the FTC holder notice (required by the FTC regulation) reads:

> NOTICE: ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF.

Id. The holder rule thus preserves claims that arose against the seller prior to assignment, so that a claim that could be brought but is not yet brought at the time of assignment of the contract is not eliminated by that assignment. *See, e.g., Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 168 F.3d 1362, 1365 (D.C. Cir. 1999) ("[T]he Holder Rule requires . . . loans supplying money for the purchase of goods or services . . . arranged by sellers to contain a notice to all loan holders that preserves the borrower's ability to raise claims and defenses against the lender *arising from the seller's misconduct*.") (emphasis added); *Riggs v. Anthony Auto Sales, Inc.*, 32 F. Supp. 2d 411, 416 (W.D. La. 1998) ("The FTC Holder Rule was, therefore, designed to reallocate the cost of *seller misconduct* to the creditor, who is in a better position to absorb the loss or recover the cost from the guilty party—the seller.") (emphasis added).

Plaintiff here never had a claim for failure to comply with Rees-Levering's post-repossession notice requirements that could have been asserted against the dealership that sold him the vehicle, and does not now assert such a claim. The claim he asserts against U.S. Bank could not have been asserted against the seller because the seller did not provide an allegedly deficient post-repossession notice. The FTC holder rule does not mean that a state statutory provision that applies to the seller must therefore apply to the assignee. The rule is about claims and defenses, not statutory obligations, and thus does not render an otherwise preempted state law, such as Rees-Levering's post-repossession notice requirements, applicable to U.S. Bank.

III. FEDERAL LAW PREEMPTS MR. AGUAYO'S UNFAIR COMPETITION LAW CLAIM FOR THE SAME REASON IT PREEMPTS HIS REES-LEVERING ACT CLAIM.

Plaintiff's cause of action for violation of the UCL is preempted because it is premised entirely on the false notion that U.S. Bank was required to comply with Rees-Levering's post-repossession notice requirements. Where a UCL claim is predicated on an underlying state law claim that is preempted by federal law, the derivative UCL claim is preempted as well. *See Rose*, 513 F.3d at 1038 (dismissing all claims under the UCL because the "legal duties that underlie" the claims for "unfair" and "deceptive" business practices are "the same purported duties to disclose . . . that are preempted by the NBA and OCC regulations"); *Martinez*, 598 F.3d at 556-68 (dismissing all claims under the UCL as federally preempted under the NBA and OCC regulations); *O'Donnell*, 2010 U.S. Dist. LEXIS 23641 (same).

Here, plaintiff's allegations concerning violation of the UCL do no more than reference and reiterate U.S. Bank's alleged failure to comply with Rees-Levering. (*See* ER 61 ¶ 26 - ER 62 ¶ 29.) The Complaint does not allege any unlawful, unfair, or fraudulent act independent of the purported failure to comply with Rees-Levering. Accordingly, plaintiff's UCL claim is preempted.

Plaintiff insists that his allegations of unfair and fraudulent conduct under the UCL are "independent" of his Rees-Levering claim. (Appellant's Br. at 57.) Plaintiff's explanations of his claims of "unfair" and "fraudulent" conduct, however, simply confirm that his UCL claim is wholly derivative of his Rees-Levering claim.

Plaintiff states that "[w]ith respect to unfair conduct, . . . U.S. Bank violates the UCL by breaching its own contractual promises to provide 'all' required notice." (*Id.*) That allegation relies on the incorrect assumption that U.S. Bank was "required" to comply with Rees-Levering, a state law whose application to national banks is preempted.

Plaintiff states that "[w]ith respect to fraudulent conduct, . . . U.S. Bank makes false statements to consumers and California courts about whether it has complied with Rees-Levering's requirements." (*Id.* at 57-58.) Again, that allegation relies on the incorrect assumption that U.S. Bank failed to comply with Rees-Levering, a statute that imposes no obligations on the bank because the statute is federally preempted.

Finally, plaintiff contends that "the Bank's post-repossession notices are likely to mislead customers" because they do not disclose other payments that customers have to make. (*Id.* at 58.) Nowhere does that allegation appear in the Complaint. Moreover, even if the Complaint contained that allegation, such a disclosure requirement would be federally preempted for the same reason Rees-Levering is preempted. Plaintiff cannot escape preemption merely by recasting his state law disclosure claim as a UCL claim. *Rose* is directly analogous. There, the plaintiffs alleged that a national bank violated California Civil Code section 1748.9, which requires certain disclosures on "convenience checks." 513 F.3d at 1034. The Ninth Circuit held that the National Bank Act preempted application of section 1748.9 to the defendant bank. *Id.* at 1038 The plaintiffs argued that their UCL claims for unfair or fraudulent conduct should nonetheless survive, because those claims were "not predicated" on a violation of section 1748.9. *Id.* The Ninth Circuit squarely rejected that argument, holding that "[r]egardless of the nature of the state law claim alleged, . . . the proper inquiry is whether the legal duty that is the predicate of Plaintiffs' state law claim falls within the preemptive power of the NBA or regulations promulgated thereunder." *Id.* (citation and internal quotations omitted). The Ninth Circuit reasoned that "Defendants' alleged legal duties that underlie Plaintiffs' UCL claims for 'deceptive' or 'unfair' business practices are the same purported duties to disclose imposed by Cal. Civ. Code § 1748.9." *Id.* The same is true here. Plaintiff argues that U.S. Bank's post-repossession notice is deceptive because it does not include the disclosures purportedly required by Rees-Levering. The "duty to disclose" at issue is the same as the purported duty to disclose under Rees-Levering, and is preempted for the same reasons.

IV. POLICY CONCERNS DO NOT PROVIDE A BASIS FOR IGNORING FEDERAL PREEMPTION OF THE REES-LEVERING NOTICE REQUIREMENTS.

Amici proffer several policy concerns that they believe support plaintiff's position that the Rees-Levering post-repossession requirements are not preempted by the National Bank Act and OCC regulations. These policy arguments do not provide a basis for ignoring the preemptive effect of federal law. Where a federal agency has issued regulations preempting state law, the court's role is limited to determining whether the agency intended to preempt the state law and, if so, whether that action is within the scope of its authority. *Barrientos v. 1801-1825 Morton LLC*, 583 F.3d 1197, 1208 (9th Cir. 2009) (quoting *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 154 (1982)). This Court cannot substitute its own policy for those judgments of the agency but instead "must uphold the federal regulation 'if the agency's choice to pre-empt represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute.'" *Id.* (quoting *City of N.Y. v. FCC*, 486 U.S. 57, 64 (1988)). In any event, *amici's* policy concerns, addressed below, are unfounded.

A. Lenders Were Not Granted a Right to Obtain Deficiency Judgments "In Exchange" for Complying with Rees-Levering's Notice Requirements.

Amici are wrong to assert that Rees-Levering's post-repossession notice requirements were a "legislative trade off" for allowing banks and holders of car notes to obtain deficiency judgments and that it would be "profoundly unfair" for the National Bank Act to preempt those notice requirements without also preempting banks' rights to recover deficiency judgments. (Amici Br. at 21 & n.9.)

The right to obtain deficiency judgments in California existed long before Rees-Levering. At common law, if a buyer defaulted in a conditional sale arrangement—a sale with scheduled payments under an installment plan, where title passes only after all payments are made—the seller could elect to either sue to recover the balance of the payments due or repossess the collateral, but not both. James Phillips, Note, *California's Automobile Deficiency Judgment Problem*, 4 U.C. Davis. L. Rev. 91, 92 (1971); William D. Warren, *Statutory Damages and the Conditional Sale*, 20 Ohio St. L.J. 289, 290 (1959). Buyers in default had no post-repossession right of redemption, and any payments they had made were forfeited. Warren, *supra*, 20 Ohio St. L.J. at 292-93. In the early twentieth century, however, courts began departing from this rigid rule and permitting the seller to repossess and resell the collateral and to collect the remaining deficiency from the debtor. *Id.* at 293-94. This became the rule in California as well. *See Matteson v. Equitable Mining & Milling Co.*, 77 P. 144 (Cal. 1904). Additionally, sellers began explicitly providing in their conditional sale contracts for the right to seek post-repossession deficiency judgment, and courts throughout the nation, including California, routinely enforced those contract terms. *See* Warren, *supra*, 20 Ohio St. L.J. at 296-97; *James v. Allen*, 72 P.2d 570, 570 (Cal. Ct. App. 1937); *Jeanson v. Zangl*, 7 P.2d 314, 315 (Cal. Ct. App. 1932).

In 1945, California enacted the Automobile Sales Act ("ASA"), 1945 Cal. Stat. 1991, which codified the pre-existing right to obtain deficiency judgments and abolished the election-of-remedies doctrine. Phillips, *supra*, 4 U.C. Davis L. Rev. at 95. And Rees-Levering, which replaced the ASA, simply maintained that status quo, as *amici* concede. (Amici Br. at 4 (right to obtain post-repossession deficiency judgments "was carried forward" in Rees-Levering).)

In sum, the right to obtain a deficiency judgment has always come from the language of the contract, not from Rees-Levering. Accordingly, there is nothing improper or unfair about preempting Rees-Levering's notice requirements without eliminating the banks' longstanding right as a secured lender to obtain a deficiency judgment after a borrower's default.

B. Preemption of The Rees-Levering Notice Requirements Does Not Leave Customers Without Protection.

Amici argue that the district court's ruling "leaves national banks free to operate unconstrained by law." (Amici Br. at 15.) That is incorrect. Laws are preempted only if they "obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized non-real estate lending powers," 12 C.F.R. § 7.4008(d)(1). As the district court correctly observed (ER 11), section 7.4008 leaves intact laws providing significant consumer protection.

Specifically, national banks continue to be subject to the UCC post-repossession notice requirements. After default, the UCC permits a secured creditor to repossess the collateral, resell it, and collect any deficiency balance from the debtor. UCC §§ 9-601(a)(1), 9-615(a), (d)(2). But the UCC also imposes specific notice requirements that the creditor must satisfy before reselling or otherwise disposing of the collateral. UCC § 9-611(b) (requiring "a reasonable authenticated notification of disposition"). The notification must, *inter alia*, describe the collateral, identify the method and time and place of intended disposition, state whether the debtor will be liable for any deficiency, notify the debtor of his or her right to an accounting, and provide contact information for the debtor to redeem the collateral and find out any additional information about the disposition. UCC §§ 9-613(1), 9-614(1).

The consumer protections established in the UCC are not preempted. When the OCC issued section 7.4008, it stated that the preemption provisions do not apply to state laws that "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." 69 Fed. Reg. 1904, 1913 (Jan. 13, 2004). The OCC made it clear that the UCC is precisely such a law and is therefore not preempted. OCC Interpr. Letter No. 1005 (June 10, 2004). The OCC explained that section 7.4008 preempts state laws that "interfere[]" with "the ability of Federally chartered institutions to operate under uniform Federal standards." *Id.* at 1. According to the OCC, the UCC is not preempted, because it simply provides "the basic legal infrastructure" that supports banking and is "a *uniform* law of general applicability on which parties rely in their daily commercial transactions." *Id.* at 2 (emphasis added).[4] This Court must give that interpretation controlling weight. *See Auer*, 519 U.S. at 461. Accordingly, *amici's* portrayal of the ruling below as permitting national banks to operate wholly unfettered by any law is wrong.

Amici misconstrue the OCC's interpretive letter as extending to Rees-Levering as well. *Amici* state that the OCC interprets section 7.4008 as not preempting any state law concerning "the subjects covered by the UCC." (Amici Br. at 25.) That language, however, is nowhere to be found in the OCC's letter. Rather, the OCC determined that the UCC is not preempted because it is uniform and therefore does not impose a patchwork of state regulation, and because it provides the basic legal framework for commercial transactions. OCC Interpr. Letter No. 1005 at 1-2. Were *amici* correct that any subject covered by the UCC is not preempted, then the OCC would not have explicitly excluded from its interpretive letter those "non-uniform provisions [of the UCC] that individual states may adopt," *id.* at 1 n.2, because such provisions would plainly concern subjects regulated by the UCC.

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[4] The OCC's determination extends only to state law implementations of the UCC that do not depart from the uniform standard. In concluding that uniform provisions of the UCC survive preemption, the OCC expressly excluded from its conclusion non-uniform UCC provisions adopted by individual states. *See id.* at 1 n.2.

Rees-Levering, unlike the UCC, is not a uniform infrastructure law of general commercial applicability. Rather, Rees-Levering is a California-specific disclosure requirement that interferes with the uniform and consistent legal framework under which national banks are permitted to operate. *See Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 13-14 (2007). Unlike the requirements of the UCC, therefore, Rees-Levering's post-repossession notice requirements are preempted.

C. Preemption of the Rees-Levering Notice Requirements Does Not Leave National Banks "Unconstrained by State Foreclosure Laws."

Amici warn, in dire tones, that preemption of Rees-Levering's notice requirements will allow national banks to engage in nonjudicial foreclosure of homes "without having to provide any notices to homeowners." (Amici Br. at 26-28.) *Amici* complain that this is unfair because California laws permitting nonjudicial foreclosure are based on a legislatively established trade-off allowing creditors to foreclose without a court judgment in exchange for providing more detailed notice. (*Id.* at 26-27.)

The policy considerations raised by *amici* concerning a different statute in a different context that may be preempted by a different OCC regulation are far beyond the scope of this litigation. The issue raised by *amici* is whether banks' right to use nonjudicial foreclosure is severable from their responsibility to provide the specific notices required in nonjudicial foreclosure proceedings. *Video Software Dealers Ass'n v. Schwarzenegger*, 556 F.3d 950, 956 (9th Cir. 2009) (provision can be severed if it is "grammatically, functionally, and volitionally separable," meaning that it "can be removed as a whole without affecting the wording," it "is not necessary to the [statute's] operation and purpose," and it "was not of critical importance to the [statute's] enactment" (quoting *Hotel Employees & Rest. Employees Int'l Union v. Davis*, 981 P.2d 990, 1009 (Cal. 1999))*, cert. granted sub nom. Schwarzenegger v. Entm't Merchs. Ass'n*, No. 08-1448, 2010 U.S. LEXIS 3573 (U.S. Apr. 26, 2010). If the notice provisions of the nonjudicial foreclosure statute were preempted, the question is whether the banks' right to use nonjudicial foreclosure would need to be preempted as well in order to preserve the statute's operation and purpose.[5] That issue is specific to the legislative intent and language of the California nonjudicial foreclosure statute, and is not affected by preemption of Rees-Levering's notice requirements. In Rees-Levering, as noted above, the notice provisions are wholly independent of the bank's right to a deficiency recovery, which is based on contract and the Uniform Commercial Code and existed long before Rees-Levering's notice requirements were enacted.

[5] U.S. Bank takes no position in this litigation on whether *amici* are correct that the right of nonjudicial foreclosure is inseverable from the responsibility to provide state-specific notices regarding such foreclosures.

D. Amici's Attack on the OCC Is Irrelevant and Unwarranted.

Amici spend a considerable portion of their brief criticizing the OCC's enforcement of consumer protection laws. (Amici Br. at 8-15.) Those criticisms are beside the point. State laws continue to apply to national banks so long as those banks do not "obstruct, impair, or condition" a national bank's lending powers. 12 C.F.R. § 7.4008(d)(1). Specifically, as explained above, the UCC's post-repossession notices apply to national banks and are not preempted. If national banks violate those UCC requirements, consumers can bring suit against them without requiring OCC involvement in any fashion. Accordingly, *amici's* long digression concerning the effectiveness of the OCC's enforcement of consumer protection laws is simply irrelevant.

In any event, contrary to *amici's* derogation of the OCC, the OCC has a long and full history of protecting consumers. *Amici* discuss what they perceive to be the OCC's lack of rigid enforcement of consumer-protection regulations, but the OCC's formal enforcement power is only one tool in its arsenal that it uses to ensure protection of consumers. Thus, "the number of formal enforcement actions," which is what *amici* rely on, "is a misleading measure of the effectiveness of [the OCC's] consumer compliance regulation." *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Financial*

Services, 110th Cong. 14 (2007) (statement of John C. Dugan, Comptroller of the Currency) ("Dugan Statement").[6]

In addition to enforcement mechanisms, the OCC extensively uses its supervisory powers to protect consumers. The OCC has exclusive supervisory powers over national banks; those powers include the power to ensure their safety and soundness as well as their compliance with applicable laws and regulations. *See* 12 U.S.C. § 484(A).[7] Exercise of its direct supervision powers is the OCC's "primary method" of overseeing national-bank operations. *Current and Future Bank Examination and Supervision Systems: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial*

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[6] The OCC also has a variety of informal enforcement procedures it can use, including requiring national bank board resolutions, memoranda of understanding, commitment letters, and other written documentation of a bank's commitment to corrective measures. OCC, *Policies & Procedures Manual: Enforcement Action Policy*, PPM 5310-3 (rev) 4, 18 (2001), *available at* http://www.occ.treas.gov/ftp/ppm/ppm-5310-3.pdf. Pursuant to federal statute, informal enforcement actions are not made public. *See* 5 U.S.C. § 552(b)(8). Accordingly, "fixating on the use of 'formal' enforcement actions exalts form over substance' and, because it 'verges on elevating publicity over effectiveness," is counterproductive. Julie L. Williams, Acting Comptroller of the Currency, Remarks before the New York Bankers Association, at 4 (July 14, 2005), *available at* http://www.occ.treas.gov/ftp/release/2005-68a.pdf.

[7] *Amici* are wrong to say that the OCC focuses on safety and soundness only, to the exclusion of consumer protection. The OCC recognizes that "compliance [with consumer protection laws] is inseparable from safety and soundness." OCC, Annual Report: Fiscal Year 2008, at 27 (2009), *available at* http://www.occ.treas.gov/annrpt/1-2008AnnualReport.pdf.

Services, 105th Cong. (1997) (prepared statement of Eugene A. Ludwig, Comptroller of the Currency), *available at* http://financialservices.house.gov/banking/10897occ.htm. The OCC's compliance regime is best described as "supervision first, enforcement if necessary," because supervision "address[es] so many problems early that enforcement often is <u>not</u> necessary." Dugan Statement at 14. Due to the OCC's leverage over national banks, "when a bank examiner comes into a [national] bank and says, 'I want you to fix something,' . . . by and large, they get very quick responses." *Oversight of the Office of the Comptroller of the Currency: Examination of Policies, Procedures and Resources: Hearing Before the H. Comm. on Financial Services*, 108th Cong. 46, 69 (2004) (testimony of John D. Hawke, Jr., Comptroller of the Currency), *available at* http://commdocs.house.gov/committees/bank/hba94902.000/hba94902_0f.htm. Simply the existence of the "potent alternative of formal enforcement proceedings" available to the OCC "ensures such voluntary compliance: 'Recommendations by the agenc[y] concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings.'" *In re Franklin Nat'l Bank Sec. Litig.*, 478 F. Supp. 210, 218 (E.D.N.Y. 1979) (quoting *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 330 (1962)).

The OCC has a dedicated Compliance Policy Department within the Office of the Chief National Bank Examiner; which is responsible for ensuring compliance with consumer-protection laws. OCC Annual Report: Fiscal Year 2009 at 30-31 (2010), *available at* http://www.occ.treas.gov/annrpt/2009AnnualReport.pdf. This Department also develops consumer-protection-compliance examination procedures for the more than 2,000 highly trained national bank examiners deployed throughout the nation (including 467 staffed permanently at the largest national banks). *Id.*; OCC 2008 Annual Report at ii, 13, 26. In addition, the OCC's Consumer Assistance Group within the Office of the Ombudsman collects and acts on consumer complaints against national banks. *See Comptroller's Handbook: Bank Supervision Process*, at 50-51 (2007), *available at* http://www.occ.treas.gov/handbook/banksup.pdf. In the first three quarters of last year alone, that group answered more than 61,000 customer inquiries and handled more than 40,000 complaints. OCC 2009 Annual Report at 44.

Perhaps the most potent tool in the OCC's consumer-protection arsenal is its rating system. The OCC assigns each national bank a consumer-compliance rating, based on its compliance with consumer-protection laws. *Bank Supervision Process* at 89-90. That rating then feeds into the bank's composite rating score, or its CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk) rating. *Id.* at 52, 59-60, 90. The CAMELS score determines whether a bank is deemed "well-managed," 12 C.F.R. § 5.34(d)(3)(i), which has serious financial, operational, and regulatory consequences.

When necessary, the OCC can and does use its formal enforcement tools to ensure compliance with consumer-protection laws. For example, in 2008, the OCC ordered one of the largest national banks to make restitution exceeding $125 million to consumers harmed by the bank's relationship with telemarketers and third-party processors and to contribute nearly $9 million to consumer-education programs. OCC Order No. 2008-159 at 4, 7 (Dec. 8, 2008), *available at* http://www.occ.treas.gov/ftp/eas/ea2008-159.pdf. And in a landmark case in 2000, the OCC ordered another large national bank to cease unfair practices (including failure to comply with disclosure requirements) and to pay consumers at least $300 million in restitution and prospective relief. *In re Providian Nat'l Bank*, Consent Order No. 2000-53, at 1-2 (June 28, 2000), *available at* http://www.occ.treas.gov/ftp/release/2000-49b.pdf. Indeed, the grave consequences resulting from formal enforcement proceedings are a compelling reason for them to not be used ubiquitously.

CONCLUSION

In sum, the National Bank Act and the OCC's implementing regulations squarely preempt the application of Rees-Levering's highly technical, state-specific disclosure requirements to automobile post-repossession notices issued by national banks. The district court's judgment should be affirmed.

Dated: May 14, 2010

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STATEMENT OF RELATED CASES

U.S. Bank is aware of no related cases in this Court.

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 13,701 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

Dated: May 14, 2010

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CERTIFICATE OF SERVICE

9th Circuit Case Number: 09-56679

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on May 14, 2010.

I certify that all of the participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

s/ James R. McGuire
James R. McGuire

sf-2825298

ADDENDUM TO APPELLEE'S BRIEF

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ADDENDUM TAB A

LEXSTAT 12 USC 24

UNITED STATES CODE SERVICE

*** CURRENT THROUGH PL 111-162, APPROVED 4/30/2010 ***

TITLE 12. BANKS AND BANKING
CHAPTER 2. NATIONAL BANKS
ORGANIZATION AND GENERAL PROVISIONS

Go to the United States Code Service Archive Directory

12 USCS § 24

§ 24. Corporate powers of associations

Upon duly making and filing articles of association and an organization certificate the [a national banking] association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power--

First. To adopt and use a corporate seal.

Second. To have succession from the date of the approval of this Act [Feb. 25, 1927], or from the date of its organization if organized after such date of approval [Feb. 25, 1927] until such time as it be dissolved by the act of its shareholders owning two-thirds of its stock, or until its franchise becomes forfeited by reason of violation of law, or until terminated by either a general or a special Act of Congress or until its affairs be placed in the hands of a receiver and finally wound up by him.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law and equity, as fully as natural persons.

Fifth. To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them and fix the penalty thereof, dismiss such officers or any of them at pleasure, and appoint others to fill their places.

Sixth. To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To 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; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on the date of the enactment of the Banking Act of 1935 [enacted Aug. 23, 1935]. As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations of the Washington Metropolitan Area Transit Authority which are guaranteed by the Secretary of Transportation under section 9 of the National Capital Transportation Act of 1969 [D. C. Code, § 1-2458], or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the thirteen banks for cooperatives or any of them or the Federal Home Loan Banks, or obligations which are insured by the Secretary of Housing and Urban Development under title XI of the National Housing Act [*12 USCS §§ 1749aaa* et seq.] or obligations which are insured by the Secretary of Housing and Urban Development (hereafter in this sentence referred to as the "Secretary") pursuant to section 207 of the National Housing Act [*12 USCS § 1713*], if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States, or obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association, or mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act [*12 USCS § 1454* or *1455*], or obligations of the Federal Financing Bank or obligations or other instruments, or securities of the Student Loan Marketing Association, or obligations of the Environmental Financing Authority, or such obligations of any local public agency (as defined in section 110(h) of the Housing Act of 1949 *[42 USCS § 1460*(h)]) as are secured by an agreement between the local public agency and the Secretary in which the local public agency agrees to borrow from said Secretary, and said Secretary agrees to lend to said local public agency, monies in an aggregate amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay, when due, the interest on and all installments (including the final installment) of the principal of such obligations, which monies under the terms of said agreement are required to be used for such payments, or such obligations of a public housing agency (as defined in the United States Housing Act of 1937, as amended [*42 USCS §§ 1437* et seq.]) as are secured (1) by an agreement between the public housing agency and the Secretary in which the public housing agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the public housing agency, prior to the maturity of such obligations, monies in an amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity thereon, which monies under the terms of said agreement are required to be used for the purpose of paying the principal of and the interest on such obligations at their maturity, (2) by a pledge of annual contributions under an annual contributions contract between such public housing agency and the Secretary if such contract shall contain the covenant by the Secretary which is authorized by subsection (b) of section 22 [subsection (g) of section 6] of the United States Housing Act of 1937 [*42 USCS § 1437d(g)*], as amended, and if the maximum sum and the maximum period specified in such contract pursuant to said subsection 22(b) [subsection 6(g)] [*42 USCS § 1437d(g)*] shall not be less than the annual amount and the period for payment which are requisite to provide for the payment when due of all installments of principal and interest on such obligations, or (3) by a pledge of both annual contributions under an annual contributions contract containing the covenant by the Secretary which is authorized by section 6(g) of the United States Housing Act of 1937 [*42 USCS § 1437d(g)*], and a loan under an agreement between the local public housing agency and the Secretary in which the public housing agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the public housing agency, prior to the maturity of the obligations involved, moneys in an amount which (together with any other moneys irrevocably committed under the annual contributions contract to the payment of principal and interest on such obligations) will suffice to provide for the payment when due of all installments of principal and interest on such obligations, which moneys under the terms of the agreement are required to be used for the purpose of paying the principal and interest on such obligations at their maturity: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus. The limitations and restrictions herein contained as to dealing in and underwriting investment securities shall not apply to obligations issued by the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development, the Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, the North American Development Bank, the Asian Development Bank, the African Development Bank, the Inter-American Investment Corporation, or the International Finance Corporation, or obligations issued by any State or political subdivision or any agency of a State or political subdivision for housing, university, or dormitory purposes, which are at the time eligible for purchase by a national bank for its own account, nor to bonds, notes or other obligations issued by the Tennessee Valley Authority or by the United States Postal Service: *Provided,* That no associations shall hold obligations issued by any of said organizations as a result of underwriting, dealing, or purchasing for its own account (and for this purpose obligations as to which it is under commitment shall be deemed to be held by it) in a total amount exceeding at any one time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. Notwithstanding any other provision in this paragraph, the association may purchase for its own account shares of stock issued by a corporation authorized to be created pursuant to title IX of the Housing and Urban Development Act of 1968 [*42 USCS §§ 3931* et seq.], and may make investments in a partnership, limited partnership, or joint venture formed pursuant to section 907(a) or 907(c) of that Act [*42 USCS § 3937(a)* or (c)]. Notwithstanding any other provision of this paragraph, the association may purchase for its own account shares of stock issued by any State housing corporation incorporated in the State in which the association is located and may make investments in loans and commitments for loans to any such corporation: *Provided,* That in no event shall the total amount of such stock held for its own account and such investments in loans and commitments made by the association exceed at any time 5 per centum of its capital stock actually paid in and unimpaired plus 5 per centum of its unimpaired surplus fund. Notwithstanding any other provision in this paragraph, the association may purchase for its own account shares of stock issued by a corporation organized solely for the purpose of making loans to farmers and ranchers for agricultural purposes, including the breeding, raising, fattening, or marketing of livestock. However, unless the association owns at least 80 per centum of the stock of such agricultural credit corporation the amount invested by the association at any one time in the stock of such corporation shall not exceed 20 per centum of the unimpaired capital and surplus of the association: *Provided further,* That notwithstanding any other provision of this paragraph, the association may purchase for its own account shares of stock of a bank insured by the Federal Deposit Insurance Corporation or a holding company which owns or controls such an insured bank if the stock of such bank or company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions or depository institution holding companies (as defined in section 3 of the Federal Deposit Insurance Act [*12 USCS § 1813*]) and such bank or company and all subsidiaries thereof are engaged exclusively in providing services to or for other depository institutions, their holding companies, and the officers, directors, and employees of such institutions and companies, and in providing correspondent banking services at the request of other depository institutions or their holding companies (also referred to as a "banker's bank"), but in no event shall the total amount of such stock held by the association in any bank or holding company exceed at any time 10 per centum of the associations capital stock and paid in and unimpaired surplus and in no event shall the purchase of such stock result in an association's acquiring more than 5 per centum of any class of voting securities of such bank or company. The limitations and restrictions contained in this paragraph as to an association purchasing for its own account investment securities shall not apply to securities that (A) are offered and sold pursuant to section 4(5) of the Securities Act of 1933 (*15 U.S.C. 77d(5)*); (B) are small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934 [*15 USCS § 78c(a)(53)*]); or (C) are mortgage related securities (as that term is defined in section 3(a)(41) of the Securities Exchange Act of 1934 (*15 U.S.C. 78c(a)(41)*). The exception provided for the securities described in subparagraphs (A), (B), and (C) shall be subject to such regulations as the Comptroller of the Currency may prescribe, including regulations prescribing minimum size of the issue (at the time of initial distribution) or minimum aggregate sales prices, or both. A national banking association may deal in, underwrite, and purchase for such association's own account qualified Canadian government obligations to the same extent that such association may deal in, underwrite, and purchase for such association's own account obligations of the United States or general obligations of any State or of any political subdivision thereof. For purposes of this paragraph--

(1) the term "qualified Canadian government obligations" means any debt obligation which is backed by Canada, any Province of Canada, or any political subdivision of any such Province to a degree which is comparable to the liability of the United States, any State, or any political subdivision thereof for any obligation which is backed by the full faith and credit of the United States, such State, or such political subdivision, and such term includes any debt obligation of any agent of Canada or any such Province or any political subdivision of such Province if--

(A) the obligation of the agent is assumed in such agent's capacity as agent for Canada or such Province or such political subdivision; and

(B) Canada, such Province, or such political subdivision on whose behalf such agent is acting with respect to such obligation is ultimately and unconditionally liable for such obligation; and

(2) the term "Province of Canada" means a Province of Canada and includes the Yukon Territory and the Northwest Territories and their successors.

In addition to the provisions in this paragraph for dealing in, underwriting, or purchasing securities, the limitations and restrictions contained in this paragraph as to dealing in, underwriting, and purchasing investment securities for the national bank's own account shall not apply to obligations (including limited obligation bonds, revenue bonds, and obligations that satisfy the requirements of *section 142(b)(1) of the Internal Revenue Code of 1986* [*26 USCS § 142(b)(1)*]) issued by or on behalf of any State or political subdivision of a State, including any municipal corporate instrumentality of 1 or more States, or any public agency or authority of any State or political subdivision of a State, if the national bank is well capitalized (as defined in section 38 of the Federal Deposit Insurance Act [*12 USCS § 1831o*]).

Eighth. To contribute to community funds, or to charitable, philanthropic, or benevolent instrumentalities conductive to public welfare, such sums as its board of directors may deem expedient and in the interests of the association, if it is located in a State the laws of which do not expressly prohibit State banking institutions from contributing to such funds or instrumentalities.

Ninth. To issue and sell securities which are guaranteed pursuant to section 306(g) of the National Housing Act [*12 USCS § 1721(g)*].

Tenth. To invest in tangible personal property, including, without limitation, vehicles, manufactured homes, machinery, equipment, or furniture, for lease financing transactions on a net lease basis, but such investment may not exceed 10 percent of the assets of the association.

Eleventh. To make investments directly or indirectly, each of which is designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families (such as by providing housing, services, or jobs). An association shall not make any such investment if the investment would expose the association to unlimited liability. The Comptroller of the Currency shall limit an association's investments in any 1 project and an association's aggregate investments under this paragraph. An association's aggregate investments under this paragraph shall not exceed an amount equal to the sum of 5 percent of the association's capital stock actually paid in and unimpaired and 5 percent of the association's unimpaired surplus fund, unless the Comptroller determines by order that the higher amount will pose no significant risk to the affected deposit insurance fund, and the association is adequately capitalized. In no case shall an association's aggregate investments under this paragraph exceed an amount equal to the sum of 15 percent of the association's capital stock actually paid in and unimpaired and 15 percent of the association's unimpaired surplus fund. The foregoing standards and limitations apply to investments under this paragraph made by a national bank directly and by its subsidiaries.

HISTORY:

(R.S. § 5136; July 1, 1922, ch 257, § 1, 42 Stat. 767; Feb. 25, 1927, ch 191, § 2, 44 Stat. 1226; June 16, 1933, ch 89, § 16, 48 Stat. 184; Aug. 23, 1935, ch 614, Title III, § 308, 49 Stat. 709; Feb. 3, 1938, ch 13, § 13, 52 Stat. 26; June 11, 1940, ch 301, 54 Stat. 261; June 29, 1949, ch 276, § 1, 63 Stat. 298; July 15, 1949, ch 338, Title VI, § 602(a), 63 Stat. 439; April 9, 1952, ch 169, 66 Stat. 49; Aug. 2, 1954, ch 649, Title II, § 203, 68 Stat. 622; Aug. 23, 1954, ch 834, § 2, 68 Stat. 771; July 26, 1956, ch 741, Title II, § 201(c), 70 Stat. 667; Aug. 6, 1959, P.L. 86-137, § 2, 73 Stat. 285; Aug. 7, 1959, P.L. 86-147, § 10, 73 Stat. 301; Sept. 8, 1959, P.L. 86-230, § 1(a), 73 Stat. 457; Sept. 16, 1959, P.L. 86-278, 73 Stat. 563; Sept. 23, 1959, P.L. 86-372, Title IV, § 420, 73 Stat. 679; Sept. 2, 1964, P.L. 88-560, Title VII, § 701(c), 78 Stat. 800; March 16, 1966, P.L. 89-369, § 10, 80 Stat. 72; Nov. 3, 1966, P.L. 89-754, Title V, § 504(a)(1), 80 Stat. 1277; May 25, 1967, P.L. 90-19, § 27(a), 81 Stat. 28; Aug. 1, 1968, P.L. 90-448, Title VIII, §§ 804(c), 807(j), Title IX, § 911, Title XVII, § 1705(h), 82 Stat. 543, 545, 550, 605; Aug. 12, 1970, P.L. 91-375, § 6(d), 84 Stat. 776; June 23, 1972, P.L. 92-318, Title I, Part D, § 133(c)(1), 86 Stat. 269; July 13, 1972, P.L. 92-349, Title I, § 101, 86 Stat. 466; Oct. 18, 1972, P.L. 92-500, § 12(n), 86 Stat. 902; Aug. 16, 1973, P.L. 93-100, § 5(c), *87 Stat.. 344;* Dec. 29, 1973, P.L. 93-224, § 14, 87 Stat. 941; Dec. 31, 1973, P.L. 93-234, Title II, § 207, 87 Stat. 984; Aug. 22, 1974, P.L. 93-383, Title II, § 206, Title VIII, § 805(c)(1), 88 Stat. 668, 726; March 31, 1980, P.L. 96-221, Title VII, Part A, § 711, 94 Stat. 189 Aug. 13, 1981, P.L. 97-35, Title XIII, Subtitle B, Part 3, § 1342(a), 95 Stat. 743; Oct. 15, 1982, P.L. 97-320, Title IV, Part A, § 404(b), 96 Stat. 1511; Jan. 12, 1983, P.L. 97-457, § 18, 96 Stat. 2509; Oct. 3, 1984, P.L. 98-440, Title I, § 105(c), 98 Stat. 1691; S. No. 2416, Title II, § 211(a), incorporated in Act Oct. 12, 1984, P.L. 98-473, Title I, § 101(1), 98 Stat. 1885; Aug. 10, 1987, P.L. 100-86, Title I, § 108, 101 Stat. 579; Sept. 28, 1988, P.L. 100-449, Title III, § 308, 102 Stat. 1877; Nov. 5, 1990, P.L. 101-513, Title V, 104 Stat. 2036, 2037; Oct. 23, 1992, P.L. 102-485, § 6(a), 106 Stat. 2774; Dec. 8, 1993, P.L. 103-182, Title V, Subtitle D, Part 2, § 541(h)(1), 107 Stat. 2167.)

(As amended Sept. 23, 1994, P.L. 103-325, Title II, Subtitle A, § 206(c), Title III, §§ 322(a)(1), 347(b), 108 Stat. 2199, 2226, 2241; Sept. 30, 1996, P.L. 104-208, Div A, Title I, § 101(c) [Title VII, § 710(b)], Title II, Subtitle G, § 2704(d)(7), 110 Stat. 3009-181, 3009-489; Nov. 12, 1999, P.L. 106-102, Title I, Subtitle F, § 151, 113 Stat. 1384; Feb. 8, 2006, P.L. 109-171, Title II, Subtitle B, § 2102(b), 120 Stat. 9; Feb. 15, 2006, P.L. 109-173, § 9(a), 119 Stat. 3616; Oct. 13, 2006, P.L. 109-351, Title III, § 305(a), 120 Stat. 1970; July 30, 2008, P.L. 110-289, Div B, Title V, § 2503(a), 122 Stat. 2857.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

References in text:

The "Federal Farm Loan Act", referred to in para. Seventh, is Act July 16, 1916, ch 245, which was classified as *12 USCS §§ 641* et seq. and was repealed by Act Dec. 10, 1971, P.L. 92-181, § 5.26(a), 85 Stat. 624. For similar provisions, see *12 USCS §§ 2001* et seq.

"This title", referred to in para. Seventh, is Title LXII of the Revised Statutes, which was comprised of R. S. §§ 5133-5243, which are classified principally to *12 USCS §§ 21*, 22-24, 25a-29, 35-37, *39*, *51*, *52*, *53*, 55-57, 59-62, *66*, *71*, 72-76, *81*, 83-91, *93*, *94*, *101a*, *102*, *104*, *107-110*, *123*, *124*, *131-138*, *141-144*, *151*, *152*, *161*, *164*, *168-175*, *181-186*, *192-196*, *481-485*, *501*, *541*, *548*, and *582*. For full classification of this Title, consult USCS Tables volumes.

Explanatory notes:

The bracketed words "a national banking" were inserted in the preliminary language for clarity.

The bracketed words "subsection (g) of section 6" and "subsection 6(g)" were inserted in the seventh paragraph as the references probably intended by Congress.

R.S. § 5136 was derived from Act June 3, 1864, ch 106, § 8, 13 Stat. 101, which Act was designated the National Bank Act. See *12 USCS § 38*.

Amendments:

1922. Act July 1, 1922, in para. Second, substituted "until ninety years from July 1, 1922, or from the date of its organization if organized after July 1, 1922, unless it shall be sooner dissolved" for "for the period of twenty years from its organization, unless it is sooner dissolved according to the provisions of its articles of association, or," and added "or unless it shall be terminated by Act of Congress hereafter enacted".

1927. Act Feb. 25, 1927, in para. Second, substituted "from the date of the approval of this act" for "until ninety-nine years from July 1, 1922, or", substituted "such date of approval until such time as it is dissolved" for "July 1, 1922, unless it shall be sooner dissolved", substituted "until its franchise becomes" for "unless its franchise shall become," and substituted "or until terminated by either a general or a special Act of Congress or until its affairs be placed in the hands of a receiver and finally wound up by him" for "or unless it shall be terminated by Act of Congress hereafter enacted",; and then added two provisos to the first sentence of para. "Seventh" which read: "*Provided*, That the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities'

ADDENDUM TAB B

LEXSTAT 12 USCS § 93A

*** CURRENT THROUGH PL 111-162, APPROVED 4/30/2010 ***

TITLE 12. BANKS AND BANKING
CHAPTER 2. NATIONAL BANKS
REGULATION OF THE BANKING BUSINESS; POWERS AND DUTIES OF NATIONAL BANKS

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12 USCS § 93a

§ 93a. Authority to prescribe rules and regulations

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, except that the authority conferred by this section does not apply to section 5155 of the Revised Statutes [*12 USCS § 36*] or to securities activities of National Banks under the Act commonly known as the "Glass-Steagall Act".

HISTORY:
(R. S. 5239A, as added March 31, 1980, P.L. 96-221, Title VII, Part A, § 708, 94 Stat. 188.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

References in text:
"The Glass-Steagall Act", referred to in this section, is Act June 16, 1933, ch 89, 48 Stat. 162, also known as "The Banking Act of 1933" or "The Glass-Steagall Act, 1933". For full classification of this Act, consult USCS Tables volumes.

NOTES:

Code of Federal Regulations:
Comptroller of the Currency, Department of the Treasury--Sales of credit life insurance, *12 CFR 2.1* et seq.
Comptroller of the Currency, Department of the Treasury--Minimum capital ratios; issuance of directives, *12 CFR 3.1* et seq.
Comptroller of the Currency, Department of the Treasury--Organization and functions, availability and release of information, contracting outreach program, *12 CFR 4.1* et seq.
Comptroller of the Currency, Department of the Treasury--Rules, policies, and procedures for corporate activities, *12 CFR 5.1* et seq.
Comptroller of the Currency, Department of the Treasury--Prompt corrective action, *12 CFR 6.1* et seq.
Comptroller of the Currency, Department of the Treasury--Bank activities and operations, *12 CFR 7.1000* et seq.

ADDENDUM TAB C

LEXSTAT 12 CFR SEC 7.4008

*** THIS SECTION IS CURRENT THROUGH THE MAY 6, 2010 ISSUE OF ***
*** THE FEDERAL REGISTER ***

TITLE 12 -- BANKS AND BANKING
CHAPTER I -- COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY
PART 7 -- BANK ACTIVITIES AND OPERATIONS
SUBPART D -- PREEMPTION

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12 CFR 7.4008

§ 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 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. n6

n6 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*.

(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; n7

n7 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 offences cognizable under the authority of the United States."

(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 non-real estate lending operations of national banks or otherwise consistent with the powers set out in paragraph (a) of this section.

HISTORY: *[69 FR 1904, 1916,* Jan. 13, 2004]

AUTHORITY: AUTHORITY NOTE APPLICABLE TO ENTIRE PART:
12 U.S.C. 1 et seq., *71*, *71a*, *92*, *92a*, *93*, *93a*, *481*, *484*, and *1818*.

NOTES: [EFFECTIVE DATE NOTE: *69 FR 1904, 1916*, Jan. 13, 2004, added this section, effective Feb. 12, 2004.]
NOTES APPLICABLE TO ENTIRE TITLE:
CROSS REFERENCES: Farmers Home Administration: See Agriculture, 7 CFR, chapter XVIII.
Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development: See Housing and Urban Development, 24 CFR, chapter II.
Fiscal Service: See Money and Finance: Treasury, 31 CFR, chapter II.
Monetary Offices: See Money and Finance: Treasury, 31 CFR, chapter I.
Commodity Credit Corporation: See Agriculture, 7 CFR, chapter XIV.
Small Business Administration: See Business Credit and Assistance, 13 CFR, chapter I.
Rural Electrification Administration: See Agriculture, 7 CFR, chapter XVII.

NOTES APPLICABLE TO ENTIRE CHAPTER:
Other regulations issued by the Department of the Treasury appear in title 19, chapter I, title 26, chapter I, title 27, chapter I, title 31, title 48, chapter 10.

NOTES TO DECISIONS: COURT AND ADMINISTRATIVE DECISIONS SIGNIFICANTLY DISCUSSING SECTION --
Rose v Chase Manhattan Bank USA, N.A. (2005, CD Cal) 396 F Supp 2d 1116
Hood v Santa Barbara Bank & Trust (2006, 2nd Dist) 143 Cal App 4th 526, 49 Cal Rptr 3d 369, 2006 CDOS 9179, 2006 Daily Journal DAR 13097, reh den (2006, Cal App 2nd Dist) 2006 Cal App LEXIS 1782 and review den, request den (2007, Cal) 2007 Daily Journal DAR 210 and cert den (2007, US) *127 S Ct 2916, 168 L Ed 2d 244*

714 words

ADDENDUM TAB D

LEXSTAT 12 CFR § 34.4

LEXISNEXIS' CODE OF FEDERAL REGULATIONS

*** THIS SECTION IS CURRENT THROUGH THE MAY 6, 2010 ISSUE OF ***
*** THE FEDERAL REGISTER ***

TITLE 12 -- BANKS AND BANKING
CHAPTER I -- COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY
PART 34 -- REAL ESTATE LENDING AND APPRAISALS
SUBPART A -- GENERAL

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12 CFR 34.4

§ 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; n1

n1 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*.

(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; n2

n2 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).

(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).

HISTORY: *[53 FR 7891*, Mar. 11, 1988; *61 FR 11294, 11301*, March 20, 1996; *69 FR 1904, 1917*, Jan. 13, 2004]

AUTHORITY: AUTHORITY NOTE APPLICABLE TO ENTIRE PART:
12 U.S.C. 1 et seq., *29*, *93a*, *371*, *1701j-3*, *1828(o)*, and *3331* et seq.

NOTES: [EFFECTIVE DATE NOTE: *69 FR 1904, 1917*, Jan. 13, 2004, revised this section, effective Feb. 12, 2004.]
NOTES APPLICABLE TO ENTIRE TITLE:
CROSS REFERENCES: Farmers Home Administration: See Agriculture, 7 CFR, chapter XVIII.
Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development: See Housing and Urban Development, 24 CFR, chapter II.
Fiscal Service: See Money and Finance: Treasury, 31 CFR, chapter II.
Monetary Offices: See Money and Finance: Treasury, 31 CFR, chapter I.
Commodity Credit Corporation: See Agriculture, 7 CFR, chapter XIV.
Small Business Administration: See Business Credit and Assistance, 13 CFR, chapter I.
Rural Electrification Administration: See Agriculture, 7 CFR, chapter XVII.

NOTES APPLICABLE TO ENTIRE CHAPTER:
Other regulations issued by the Department of the Treasury appear in title 19, chapter I, title 26, chapter I, title 27, chapter I, title 31, title 48, chapter 10.

NOTES APPLICABLE TO ENTIRE PART:
[PUBLISHER'S NOTE: For Federal Register citations concerning Part 34 temporary exceptions, see *58 FR 42640 (1993); 59 FR 62562*, Dec. 6, 1994; *70 FR 59987*, Oct. 14, 2005.]

NOTES TO DECISIONS: COURT AND ADMINISTRATIVE DECISIONS SIGNIFICANTLY DISCUSSING SECTION --
Watters v Wachovia Bank, N.A. (2007, US) 127 S Ct 1559, 167 L Ed 2d 389, 20 FLW Fed S 170

695 words

ADDENDUM TAB E

LEXSTAT 12 CFR 560.2

LEXISNEXIS' CODE OF FEDERAL REGULATIONS

*** THIS SECTION IS CURRENT THROUGH THE MAY 6, 2010 ISSUE OF ***
*** THE FEDERAL REGISTER ***

TITLE 12 -- BANKS AND BANKING
CHAPTER V -- OFFICE OF THRIFT SUPERVISION, DEPARTMENT OF THE TREASURY
SUBCHAPTER A -- ORGANIZATION AND PROCEDURES
PART 560 -- LENDING AND INVESTMENT

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12 CFR 560.2

§ 560.2 Applicability of law.

(a) Occupation of field. Pursuant to sections 4(a) and 5(a) of the HOLA, *12 U.S.C. 1463(a)*, *1464(a)*, OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or § 560.110 of this part. For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

(b) Illustrative examples. Except as provided in § 560.110 of this part, the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:

(1) Licensing, registration, 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;

(3) Loan-to-value ratios;

(4) The terms of credit, including amortization of loans and the deferral and capitalization of interest and adjustments to the interest rate, balance, payments due, 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) Loan-related fees, including without limitation, initial charges, late charges, prepayment penalties, servicing fees, and overlimit fees;

(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 and laws requiring creditors to supply copies of credit reports to borrowers or applicants;

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

(11) Disbursements and repayments;

(12) Usury and interest rate ceilings to the extent provided in *12 U.S.C. 1735f-7a* and part 590 of this chapter and *12 U.S.C. 1463(g)* and § 560.110 of this part; and

(13) Due-on-sale clauses to the extent provided in *12 U.S.C. 1701j-3* and part 591 of this chapter.

(c) State laws that are not preempted. State laws of the following types are not preempted to the extent that they only incidentally affect the lending operations of Federal savings associations or are otherwise consistent with the purposes of paragraph (a) of this section:

(1) Contract and commercial law;

(2) Real property law;

(3) Homestead laws specified in *12 U.S.C. 1462a(f)*;

(4) Tort law;

(5) Criminal law; and

(6) Any other law that OTS, upon review, finds:

(i) Furthers a vital state interest; and

(ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.

HISTORY: *[61 FR 50951*, *50972*, Sept. 30, 1996]

AUTHORITY: AUTHORITY NOTE APPLICABLE TO ENTIRE PART:
12 U.S.C. 1462, *1462a*, *1463*, *1464*, *1467a*, *1701j-3*, *1828*, *3803*, *3806*; *42 U.S.C. 4106*.

NOTES: [EFFECTIVE DATE NOTE: *61 FR 50951*, *50972*, Sept. 30, 1996, added Part 560, effective Oct. 30, 1996.]
NOTES APPLICABLE TO ENTIRE TITLE:
CROSS REFERENCES: Farmers Home Administration: See Agriculture, 7 CFR, chapter XVIII.
Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development: See Housing and Urban Development, 24 CFR, chapter II.
Fiscal Service: See Money and Finance: Treasury, 31 CFR, chapter II.
Monetary Offices: See Money and Finance: Treasury, 31 CFR, chapter I.
Commodity Credit Corporation: See Agriculture, 7 CFR, chapter XIV.
Small Business Administration: See Business Credit and Assistance, 13 CFR, chapter I.
Rural Electrification Administration: See Agriculture, 7 CFR, chapter XVII.

NOTES APPLICABLE TO ENTIRE CHAPTER:
[EDITORIAL NOTE 1: Nomenclature changes to Chapter V appear at *59 FR 18475*, Apr. 19, 1994, and at *60 FR 66715*, Dec. 26, 1995.]

NOTES TO DECISIONS: COURT AND ADMINISTRATIVE DECISIONS SIGNIFICANTLY DISCUSSING SECTION --

Alkan v Citimortgage, Inc. (2004, ND Cal) 336 F Supp 2d 1061
Am. Bankers Ass'n v Lockyer (2002, ED Cal) 239 F Supp 2d 1000
Burks v Arvest Bank (2006, ED Ark) 2006 US Dist LEXIS 89178
Haehl v Wash. Mut. Bank, F.A. (2003, SD Ind) 277 F Supp 2d 933
Albank, FSB v Foland (1998, City Ct) 177 Misc 2d 569, 676 NYS2d 461
Chaires v Chevy Chase Bank, F.S.B. (2000) 131 Md App 64, 748 A2d 34, cert den *(2000) 359 Md 334, 753 A2d 1031*
Lopez v World Savings & Loan Assn. (2003, 1st Dist) 105 Cal App 4th 729, 130 Cal Rptr 2d 42, 2003 CDOS 750, 2003 Daily Journal DAR 901, review den, request den (2003, Cal) 2003 Daily Journal DAR 5219
McKell v Washington Mutual, Inc. (2006, 2nd Dist) 142 Cal App 4th 1457, 49 Cal Rptr 3d 227, 2006 CDOS 8836, 2006 Daily Journal DAR 12639, request den (2007, Cal) *2007 Cal LEXIS 319* and (criticized in *Jefferson v Chase Home Fin. LLC (2007, ND Cal) 2007 US Dist LEXIS 36298)*
Pinchot v Charter One Bank (2003) 99 Ohio St 3d 390, 2003 Ohio 4122, 792 NE2d 1105
Rosenberg v Washington Mut. Bank, FA (2004, App Div) 369 NJ Super 456, 849 A2d 566
Washington Mutual Bank v Superior Court (2002, 2nd Dist) 95 Cal App 4th 606, 115 Cal Rptr 2d 765, 2002 CDOS 700, 2002 Daily Journal DAR 901
Weiss v Washington Mutual Bank (2007, 2nd Dist) 147 Cal App 4th 72, 53 Cal Rptr 3d 782, 2007 Daily Journal DAR 1272
Wells v Chevy Chase Bank, F.S.B. (2003) 377 Md 197, 832 A2d 812, cert den *(2004) 541 US 983, 124 S Ct 1875, 158 L Ed 2d 485*

720 words

ADDENDUM TAB F

LEXSTAT 16 CFR 433.2

*** THIS SECTION IS CURRENT THROUGH THE MAY 6, 2010 ISSUE OF ***
*** THE FEDERAL REGISTER ***

TITLE 16 -- COMMERCIAL PRACTICES
CHAPTER I -- FEDERAL TRADE COMMISSION
SUBCHAPTER D -- TRADE REGULATION RULES
PART 433 -- PRESERVATION OF CONSUMERS' CLAIMS AND DEFENSES

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16 CFR 433.2

§ 433.2 Preservation of consumers' claims and defenses, unfair or deceptive acts or practices.

In connection with any sale or lease of goods or services to consumers, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for a seller, directly or indirectly, to:

(a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

or,

(b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

HISTORY: *[40 FR 53506*, Nov. 18, 1975; *40 FR 58131*, Dec. 15, 1975]

AUTHORITY: *38 Stat. 717*, as amended; (*15 U.S.C. 41*, et seq.)

NOTES TO DECISIONS: COURT AND ADMINISTRATIVE DECISIONS SIGNIFICANTLY DISCUSSING SECTION --

Lozada v Dale Baker Oldsmobile, Inc. (2000, WD Mich) 91 F Supp 2d 1087 (criticized in *Johnson v West Suburban Bank (2000, CA3 Del) 225 F3d 366, 48 FR Serv 3d 168)* and (criticized in *Pyburn v Bill Heard Chevrolet (2001, Tenn App) 63 SW3d 351)* and (criticized in *Hale v First USA Bank, N.A. (2001, SD NY) 2001 US Dist LEXIS 8045)* and (criticized in *Gras v Assocs. First Capital Corp. (2001, App Div) 346 NJ Super 42, 786 A2d 886)* and (criticized in *Adams v Am. Residential Servs., L.L.C. (2003, DC Dist Col) 2003 US Dist LEXIS 26478)*

Rollins v Drive-1 of Norfolk, Inc. (2006, ED Va) 2006 US Dist LEXIS 61197

Hancock v HomEq Servicing Corp. (2007, DC Dist Col) 2007 US Dist LEXIS 31051

Kaliner v Mortg. Elec. Registration Sys. (In re Reagoso) (2007, BC ED Pa) 2007 Bankr LEXIS 2004

Bescos v Bank of America (2003, 2nd Dist) 105 Cal App 4th 378, 129 Cal Rptr 2d 423, 2002 CDOS 511, 2003 Daily Journal DAR 581, request den (2003, Cal) *2003 Cal LEXIS 5231*

Jaramillo v Gonzales (2002, App) 2002 NMCA 72, 132 NM 459, 50 P3d 554, 49 UCCRS2d 159, cert den *(2002) 132 NM 288, 47 P3d 447*

Jarvis v S. Oak Dodge, Inc. (2002) 201 Ill 2d 81, 265 Ill Dec 877, 773 NE2d 641

LaChapelle v Toyota Motor Credit Corp. (2002, 1st Dist) 102 Cal App 4th 977, 126 Cal Rptr 2d 32, 2002 CDOS 10286, 2002 Daily Journal DAR 11817, 49 UCCRS2d 202

Scott v Mayflower Home Imp. Corp. (2001, Law Div) 363 NJ Super 145, 831 A2d 564 (ovrld in part by *Psensky v American Honda Finance Corp. (2005, App Div) 378 NJ Super 221, 875 A2d 290)*

225 words

ADDENDUM TAB G

LEXSEE 61 FED. REG. 50951

FEDERAL REGISTER

Vol. 61, No. 190

Rules and Regulations

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision (OTS)

12 CFR Parts 545, 556, 560, 563, 566, 571, 590

[No. 96-87]

RIN 1550-AA94

Lending and Investment

61 FR 50951

DATE: Monday, September 30, 1996

ACTION: Final rule.

To view the next page, type .np* TRANSMIT.
To view a specific page, transmit p* and the page number, e.g. p*1

[*50951]

SUMMARY: The Office of Thrift Supervision (OTS or Office) is today issuing a final rule updating, reorganizing, and substantially streamlining its lending and investment regulations and policy statements. These amendments are being made pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review (Reinvention Initiative) and section 303 of the Community Development and Regulatory Improvement Act of 1994 (CDRIA), which requires OTS and the other federal banking agencies to review, streamline, and modify regulations and policies to improve efficiency, reduce unnecessary costs, and remove inconsistent, outmoded, and duplicative requirements.

EFFECTIVE DATE: October 30, 1996.

FOR FURTHER INFORMATION CONTACT: For general information contact: William J. Magrini, Senior Project Manager, (202) 906-5744, Supervision Policy; Ellen J. Sazzman, Counsel (Banking and Finance), (202) 906-7133; or Deborah Dakin, Assistant Chief Counsel, (202) **[*50952]** 906-6445, Regulations and Legislation Division, Chief Counsel's Office. For information about preemption, contact Evelyne Bonhomme, Counsel (Banking and Finance), (202) 906-7052, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

In a comprehensive review of its regulations, beginning in the spring of 1995, pursuant to section 303 of the CDRIA n1 and the Administration's Reinvention Initiative, OTS identified its lending and investment regulations as an important area for updating and streamlining. Lending and investment are key areas of thrift operations and these regulations had not been comprehensively reviewed in a number of years. Each lending and investment regulation was reviewed to determine whether it was current and understandable; could be eliminated without endangering safety and soundness, diminishing consumer protection or violating statutory requirements; addressed subject matter more suited for handbook guidance; and was consistent with the regulations of the other banking agencies. OTS also sought industry input regarding staff's initial recommendations through an industry focus group meeting among seven thrift representatives, an industry trade association and OTS staff. As a result of this review, OTS identified a number of ways in which its lending and investment regulations could be revised to reduce regulatory burden. On January 17, 1996, OTS issued a notice of proposed rulemaking. n2

n1 *12 U.S.C. 4803*(a)(1).

n2 *61 FR 1162* (January 17, 1996).

Today's final rule is substantially similar to the January proposal. Readers will note, however, that the final rule also sets forth, for ease of reference, the full text of OTS's regulations on lending limits, real estate lending standards, disclosures on adjustable-rate mortgages, and the reappraisal of real estate owned (REO). These regulations have been moved, with only technical and conforming changes, into new Part 560, Lending and Investment, so that all lending regulations will be grouped together and more easily located. The final rule also incorporates technical corrections to fix cross-references in other regulations to regulations that are being modified, moved, or removed as part of this final rule.

The final rule reduces the number of lending and investment regulations from 43 to 23 and results in a net reduction of 11 pages of CFR text. As it proposed, OTS has removed unnecessary, duplicative, and outdated lending and investment regulations such as § 563.97 (loans in excess of 90% of value), § 545.44 (mortgage transactions with the Federal Home Loan Mortgage Corporation (Freddie Mac)), and § 545.37 (combination loans). OTS has also revised certain regulations to be less burdensome, *e.g.*, amending the scope of commercial loans under current § 545.46(b) to exclude commercial loans made by service corporations from its parent's percentage-of-assets limitations and removing restrictions on manufactured home loans and investments in government securities and state housing corporations.

OTS has also converted the detail in some regulations into guidance to give thrifts more flexibility in addressing safety and soundness concerns in a particular area, *e.g.*, current § 563.160 (loan classification) and current § 563.170(c) (loan documentation). OTS's movement toward a more guidance-oriented approach in the lending and investment area brings OTS's regulations into greater uniformity with those of the other federal banking agencies consistent with the objectives of section 303 of the CDRIA.

OTS's objective in removing the detail from some regulations and relying on a more general set of regulations and safety and soundness standards is to allow institutions greater flexibility in their lending and investment operations. However, OTS still insists that an association maintain adequate loan documentation, classify its assets, and establish appropriate valuation allowances consistent with generally accepted accounting principles and safety and soundness.

OTS is also sensitive to commenters' concerns regarding the potential for examiners to treat guidelines as binding regulations. OTS will emphasize the proper interpretation of supervisory guidance in its examiner training programs to ensure that guidance is not treated in the same manner as binding regulations.

OTS has also reorganized its lending and investment regulations to make them easier to locate and use. First, all lending and investment regulations have been moved to a new Part 560, "Lending and Investment," that specifies which regulations apply to all savings associations (such as loan documentation, disclosure, and real estate lending standards) and which apply only to federal savings associations (such as specific lending powers.) This part incorporates provisions currently located in Parts 545 and 563 that are being modified as part of today's final rule. It also incorporates sections currently located in Part 563 that are being transferred to Part 560 without change. These regulations-real estate lending standards, disclosure requirements for adjustable-rate mortgages, lending limits, and appraisal requirements for real estate owned-are being moved to Part 560 for the convenience of those using OTS's lending regulations.

OTS has also removed unnecessary restatements of statutory authority and limitations from various sections of Part 545 and replaced them with a regulation in chart format that provides easy reference to the statutory authority for, and limitations on, federal associations' lending and investment powers.

OTS has added a general lending preemption provision in new Part 560. This provision (discussed more fully in the section-by-section analysis in Sec. II.B. below) restates long-standing preemption principles applicable to federal savings associations, as reflected in earlier regulations, court cases, and numerous legal opinions issued by OTS and the Federal Home Loan Bank Board (FHLBB), OTS's predecessor agency. In those opinions, OTS has consistently taken the position that, with certain narrow exceptions, any state laws that purport to affect the lending operations of federal savings associations are preempted. None of the changes implemented today should be construed as evidencing in any way an intent by OTS to change this long held position: OTS still intends to occupy the field of lending regulation for federal savings associations. OTS believes that the new lending preemption regulation is clearer and should significantly reduce the instances in which institutions need to request interpretive guidance from OTS.

In summary, OTS believes that regulations that address safety and **[*50953]** soundness requirements should generally be limited to those requirements necessary for OTS to carry out its supervisory responsibilities. If regulations are unnecessarily detailed and rigid, regulated entities may find themselves unable to respond to market innovations. Today's final rule achieves what OTS believes is the right balance by placing essential safety and soundness requirements in binding regulations and putting more expansive guidance on sensible practices in handbooks.

II. Summary of Comments and Description of the Final Rule

A. General Discussion of the Comments

The public comment period on the January 17 proposal closed on April 16, 1996. Fourteen commenters responded to the notice of proposed rulemaking. Seven federal savings associations, three national financial institution trade associations, two law firms, one national bank, and one state appraiser trade association submitted comments.

All but one of the commenters generally supported OTS efforts to update, streamline, and reorganize its lending and investment regulations. Commenters praised OTS's proposed elimination of unnecessary and burdensome lending and investment restrictions and indicated that the proposed modifications would be helpful. Commenters believed that the proposed changes would significantly reduce the compliance burden on the thrift industry and facilitate greater operational flexibility and product innovation. Commenters generally concurred with OTS's view that many of the proposed amendments would provide savings associations with the flexibility needed to compete with other financial institutions, particularly commercial banks, to engage in new lending activities made possible by technological changes, and to respond more quickly to market innovation. Most commenters also supported the consolidation of all lending and investment regulations into a new Part 560.

Commenters also generally supported OTS's proposal to shift some of its regulations to guidance in the Thrift Activities Handbook (Handbook). Commenters noted that moving specific loan documentation requirements currently found in § 563.170, specific loan classification requirements currently in § 563.160, and restrictions on investments in commercial paper and corporate debt securities currently in § 545.75 into the Handbook was appropriate, given that OTS now has more sophisticated examination and reporting methods and better trained examiners to monitor thrift activities. Commenters recognized that OTS regulations traditionally have been more detailed and less flexible than those applicable to banks. They agreed that OTS's proposal to move from a somewhat regulation-specific to a more guidance-oriented approach would give thrifts more flexibility to address safety and soundness concerns in a manner best suited to each individual institution. Commenters also believed that shifting OTS regulations into the Handbook would reduce the costs of regulatory compliance by increasing a thrift's operational flexibility.

At least one commenter was concerned, however, that the Handbook could become so detailed that it would stifle product innovation and management judgment or duplicate provisions that remained in the regulations. Commenters also expressed the concern that examiners might view guidelines in the Handbook as binding requirements with no resulting relief in regulatory burden. To prevent this, commenters supported OTS's plan to provide examiner training that would emphasize the intended flexibility of supervisory guidance. Additionally, OTS is reviewing the text of regulations being repealed today to determine what portions will provide helpful guidance and what portions should be disposed of altogether. The process of converting regulatory text to guidance will be done thoughtfully, recognizing the different roles performed by regulations and guidance.

A number of commenters raised concerns that the proposed changes on preemption of state laws affecting lending might be misunderstood as a narrowing of OTS's traditional preemption position. These concerns are discussed in detail in the section-by-section analysis below in reference to § 560.2.

B. Section-by-Section Analysis

1. Existing Lending and Investment Sections

Section 545.31 Election Regarding Classification of Loans or Investments

OTS proposed retaining in modified form paragraph (a) of § 545.31, which set forth OTS's general rule that where a loan or investment meets the requirements of more than one authorizing provision, the association may elect to place it in any applicable category. OTS received no comments on this paragraph, which is retained as proposed, in modified form, as new § 560.31.

OTS also proposed retaining paragraph (b) of § 545.31, which provided that loan commitments are included in total assets and accounted for as an investment for purposes of determining applicable statutory or regulatory investment authority limitations only to the extent that funds are advanced and not repaid. n3 OTS received no comments on this paragraph, which is retained as proposed as part of new § 560.31(a).

n3 Today's final rule carries forward this longstanding treatment of loan commitments for purposes of HOLA section 5(c) investment limitations. OTS notes, however, that contractual commitments to advance funds continue to be considered "loans and extensions of credit" under the loans-to-one borrower regulation (existing § 563.93, now § 560.93).

OTS proposed retaining paragraphs (c) and (d) of § 545.31, which addressed respectively the treatment of loans sold to third parties for purposes of calculating percentage-of-assets investment limitations and treatment of loans secured by assignment of loans. OTS received no comments on these paragraphs, which are retained in new § 560.31. One commenter addressing the treatment of commercial loans did suggest that OTS explicitly state that commercial loans sold or participated out do not count toward a thrift's 10 percent commercial loan limit. OTS believes that new § 560.31(b), which provides that loans sold to a third party are only included in calculating a percentage-of-assets investment limitation to the extent that they are sold with recourse, addresses this point. In response to the commenter, OTS is adding the phrase "or portions of loans" to the regulation to clarify that any portion of participation loans sold without recourse need not be aggregated when calculating loans subject to any percentage-of-assets investment limit.

The January proposal indicated that the definitions of "real estate loan" and "loan commitment" would be addressed in a later rulemaking that would review the overall structure of OTS's regulations and might move OTS regulatory definitions into a common part of the Code of Federal Regulations (CFR) (the Regulatory Structure rulemaking). In order to avoid confusion pending that rulemaking, however, OTS has decided to incorporate these definitions, substantially unchanged, into a new "Definitions" section, § 560.3. The future Regulatory Structure rulemaking may review these definitions to determine if they should be modified, removed, or relocated to another location in the regulations. **[*50954]**

Section 545.32 Real Estate Loans

Consistent with its regulatory streamlining efforts, OTS proposed deleting paragraph (a) of § 545.32 and moving its statutory reference into the new lending and investment powers chart. Paragraph (a) reiterated the Home Owners' Loan Act's (HOLA's) general grant of authority for federal savings associations to make or invest in residential (home) or nonresidential real estate loans n4 and explicitly authorized federal savings associations to "originate, invest in, sell, purchase, service, participate or otherwise deal in (including brokerage and warehousing) [real estate] loans." One commenter did suggest that OTS clarify that deletion of paragraph (a) is not intended to eliminate any of the activities in which federal savings associations may engage with respect to real estate loans. OTS is deleting paragraph (a) as proposed. However, OTS wishes to emphasize that it does not intend any change in federal thrifts' authority to conduct these activities. OTS is moving the statutory reference in paragraph (a) into the new lending and investment powers chart at § 560.30.

n4 *12 U.S.C. 1464*(c)(1)(B), (c)(2)(B).

OTS also proposed to delete paragraphs (b)(1) and (b)(2) of § 545.32, because these sections duplicated more comprehensive interagency-developed real estate lending standards and appraisal standards set forth at 12 CFR 563.100-563.101 and 12 CFR Part 564, respectively. OTS received no comments on these paragraphs and is deleting them as proposed. As part of today's rulemaking, the real estate lending standards are being moved into Part 560 as new § 560.100-560.101.

OTS also proposed deleting paragraphs (b) (3), (4), (5), and (6) of § 545.32. These paragraphs discussed federal savings associations' authority to adjust the terms of real estate loans, to amortize real estate loans, to charge certain initial fees for real estate loans, and to establish escrow accounts. OTS believes that the authority to adjust, amortize, establish escrow accounts for, and charge fees for loans properly falls within the scope of a federal savings association's statutory authority to originate loans pursuant to the HOLA, n5 and these particular aspects of lending do not need to be specifically identified or restricted in the CFR. Although commenters generally supported elimination of these paragraphs, one commenter raised the concern that if OTS removed specific regulatory language referring to the authority of federal thrifts to adjust terms, amortize, charge certain fees, and establish escrow accounts for real estate loans, states may challenge whether OTS continues to occupy the field of federal thrift lending regulation and may attempt to impose their own lending regulations on thrifts. However, by removing these paragraphs, OTS does not intend any narrowing of federal thrifts' authority to conduct these activities, but rather to enhance associations' flexibility in lending. Each of these areas is specifically cited in the new § 560.2 as an area in which state law is preempted. Whether OTS continues to have a specific regulation or chooses to remove a federal regulation to streamline its regulations and reduce regulatory burden, the agency still intends to occupy the entire field of lending regulation for federal savings associations. Accordingly, OTS is deleting paragraphs (b) (3), (4), (5), and (6) as proposed.

n5 *12 U.S.C. 1464*(c)(1)(B), (c)(2)(B).

Paragraph (c) of § 545.32 defined the phrase "loan made on the security of real estate." In its proposal OTS sought comment on whether the current definition of secured real estate loan has provided adequate guidance for savings associations. One commenter indicated that the current definition does not adequately deal with situations involving state single action rules. OTS will consider this comment when the agency proceeds with the definitional portion of the Regulatory Structure rulemaking. In the interim, this definition is being included in § 560.3, "Definitions."

OTS proposed deleting paragraph (d) of § 545.32, which addressed loan-to-value ratios, because it duplicates more comprehensive interagency real estate lending standards. Commenters supported elimination of this paragraph and OTS is deleting paragraph (d) as proposed.

Section 545.33 Home Loans

In the proposal, OTS indicated that it was considering moving the introductory paragraph of § 545.33 to a common definitional section of the regulations as part of the Regulatory Structure Proposal. OTS received no comments on this language, which generally describes home loans and will retain this paragraph as part of § 560.3 "Definitions," until its reconsideration during the definitional rulemaking.

OTS proposed to delete paragraph (a) of § 545.33. This section described the authority of federal savings associations to amortize home loans. One commenter did raise a concern that deletion of this section could throw into question federal preemption of state laws prohibiting balloon payments. As discussed under § 545.32(b) (3)-(6), the authority to amortize home loans properly falls within the scope of savings associations' statutory authority to originate loans and does not need to be specifically identified in the CFR. New § 560.2 specifically confirms that states cannot regulate how federal savings associations amortize their loans. Accordingly, OTS is deleting paragraph (a) as proposed.

OTS proposed to delete paragraph (b), which addressed loan-to-value ratios (LTV) for home loans. Commenters agreed with OTS's view that the interagency real estate lending standards address the same issues in a more comprehensive and current manner and supported deletion of this paragraph. OTS is deleting paragraph (b) as proposed.

One commenter did contend that some language in paragraph (b) should be retained to make clear that home loans that comply at origination with the LTV ratios set forth in the interagency real estate lending standards but thereafter exceed them due to negative amortization should not require special recordkeeping or reporting to a thrift's board of directors. OTS has no requirement in either the real estate lending guidelines or its regulations that such loans be reported to a thrift's board and so removing this paragraph does not impose any new reporting requirements on thrifts.

OTS proposed to delete paragraph (c), which set forth limitations on the adjustments that may be made to the terms of residential mortgages. It requires that adjustments to rates, payments, or loan balances be tied to a national or regional index beyond the control of the savings association or a formula or schedule set forth in the loan contract. These limitations on federal savings associations are generally much more restrictive than those applicable to state-chartered lenders offering mortgages and have not been revised since 1983, when adjustable rate mortgage (ARM) loans were still relatively new in the marketplace. Federal savings associations must also comply with the notice and disclosure requirements of current § 563.99.

OTS proposed to delete paragraph (c), including the external index requirement, to give thrifts and consumers greater flexibility in structuring ARM transactions. Most commenters supported the proposed deletion, agreeing that it would give thrifts additional flexibility to compete with other mortgage lenders not subject to similar requirements. These commenters also agreed that the competitive market place makes such **[*50955]** requirements unnecessary given the wide variety of possible sources for home mortgage loans. Commenters also confirmed that consumers have become familiar with ARM loans and receive detailed disclosures when requesting such loans. The majority of commenters addressing the issue concluded that as long as information about adjustments is clearly disclosed to purchasers, the terms of the ARM loan should be a matter of contract between the savings association and the purchaser. n6

n6 One commenter suggested removing all caps on ARM loans. The OTS notes that *12 U.S.C. 3806*, which applies to all creditors, including savings associations, requires that all ARM loans, as defined in that section, include limitations on the maximum interest rate applicable during the loan term.

One commenter, a bank trade association, opposed the removal of this requirement, arguing that it would be inconsistent with the Office of the Comptroller's decision to retain such a requirement for national banks. n7 Another commenter, a trade association representing savings associations and banks, suggested further study before removing the requirement. Both commenters suggested that consumers might be better protected by retaining this requirement. The second commenter emphasized the importance of adequate disclosure.

n7 See *61 FR 11294, 11297* (March 20, 1996).

Upon review of the comments received, OTS has decided to adopt a new section, § 560.35, "Adjustments to Home Loans," requiring that a federal savings association generally use a national or regional index for ARM loans. Examples of such acceptable indices include the Eleventh District's Cost of Funds Index and indices tied to one-year Treasury bills. OTS has also decided, however, to give an association the flexibility to use alternative indices after notifying OTS. The notice should address how indices will be derived, how the association will ensure the indices' availability and verifiability, and how the indices will be disclosed to borrowers. Additionally, the notice should outline the internal controls and processes that the association will put in place to administer and monitor such indices. Once OTS has reviewed and not objected to an institution's internal procedures for the use of alternative indices, subsequent notices need only address how new indices are derived. If OTS does not object within 30 days, the association may proceed with using alternative indices. Use of alternative indices will also be reviewed as part of the agency's safety and soundness and compliance examinations.

The foregoing changes do not affect the requirement that any index used must be readily available, independently verifiable, and adequately disclosed in accordance with the Truth in Lending Act, any applicable regulations, and new § 560.210, which replaces existing § 563.99. Associations still may use one or more indices or a formula or schedule set forth in the loan contract to adjust the interest rate, payments, or loan balance.

OTS believes that this change will allow institutions potentially greater flexibility in structuring and managing their loan portfolios while allowing the agency the opportunity to review an association's proposed ARM loan program, structure, and safeguards to determine whether they would result in a suitable index to use for ARM transactions. Consumers will continue to have the protection of a verifiable and disclosed index and of OTS review. In response to the commenters who noted that the Office of the Comptroller of the Currency (OCC) has recently taken a different position on this issue, OTS notes that the external indices issue is more important for federal thrifts than it is for national banks. Unlike banks, thrifts are subject to the Qualified Thrift Lender (QTL) rule. That statutorily mandated rule, 12 CFR 563.50-563.52, requires thrifts to hold an average of 65% or more of their assets in residential mortgage loans. Because national banks have no such requirement, they often originate such loans, but then sell them in the secondary mortgage market. They rarely would have the occasion to develop an alternative index because the secondary market usually requires the use of an outside index.

Because thrifts must hold the majority of their assets in residential mortgages, they are more vulnerable to interest rate risk than national banks. Enabling thrifts to tie their yields on 1-4 family residential loans with the rates they pay on deposits would help thrifts to manage this risk and offset the competitive disadvantage resulting from the QTL rule.

No commenters addressed the other requirements of § 545.33(c) (4)-(5), which are being removed as proposed.

OTS proposed to delete paragraph (d) of § 545.33, which addressed loans on cooperatives. Commenters agreed with OTS's view that the interagency real estate lending standards address the same issues in a more comprehensive and flexible manner and that this paragraph was duplicative of those lending standards. OTS is deleting paragraph (d) as proposed.

OTS proposed deleting paragraph (e) of § 545.33, which addressed loans to facilitate trade-in or exchange, because the interagency real estate lending standards cover the same issues in a more comprehensive and flexible manner. Commenters supported deletion of this paragraph. OTS is deleting paragraph (e) as proposed.

Paragraph (f) of § 545.33 specifies which OTS regulations must be followed by state savings associations and certain other state lenders who elect to make loans under the Alternative Mortgage Parity Act. n8 The Alternative Mortgage Parity Act preempts state laws that might otherwise limit certain state creditors' ability to offer alternative mortgage instruments if they comply with the OTS regulations identified in this paragraph. OTS proposed moving paragraph (f) in order to make it more accessible and easier to locate and to clarify that all OTS lending regulations apply to loans originated under the Parity Act. OTS received no comments on this proposed change. Accordingly, OTS is moving the provisions of this paragraph, as modified to reflect changes elsewhere in today's final rule, into new § 560.220, as part of a subpart specifically dealing with alternative mortgages. The title of that subpart and § 560.220, will highlight the content, making it easier for those unfamiliar with OTS's regulations to locate.

n8 The Alternative Mortgage Parity Act, Pub. L. 97-320, Title VII (Parity Act), *12 U.S.C. 3801 et seq.*, authorizes certain housing creditors to make alternative mortgage transactions notwithstanding any contrary state law under certain conditions. Housing creditors that rely on the Parity Act and are not commercial banks or credit unions must comply with applicable OTS lending regulations.

Section 545.34 Limitations for Home Loans Secured by Borrower-Occupied Property

OTS proposed removing paragraph (a) of § 545.34 and incorporating its provisions into the new consolidated lending preemption regulation at § 560.2. Paragraph (a) confirmed that federal savings associations may include due-on-sale clauses in loan instruments to the extent authorized under federal statutes and regulations regardless of state prohibitions of due-on-sale clauses. n9 OTS received no comments on this proposed change, which is adopted as proposed.

n9 *12 U.S.C. 1701j-3;* 12 CFR Part 591.

Paragraphs (b) and (c) permitted federal savings associations to include provisions imposing late fees and prepayment penalties in loan contracts on home loans subject to certain conditions. OTS proposed removing these paragraphs and incorporating their limitations into new § 560.34. The three commenters who discussed these **[*50956]** paragraphs supported this reorganization. Upon further review, however, OTS believes that separating these two paragraphs into two separate, more specifically identified, regulations will make them easier for users to locate. New § 560.33 will cover late charges and new § 560.34 will address prepayment penalties.

Two commenters also suggested that OTS reduce or eliminate the required fifteen-day grace period for borrowers before imposition of a late charge. The commenters noted that only OTS, among federal bank regulators, has such a lengthy grace period, and suggested at least reducing the period to ten days to put savings associations on a more level playing field with other mortgage lenders. OTS believes that the fifteen-day grace period does not impose a hardship on institutions. OTS is retaining the fifteen-day grace period in the final rule.

One commenter also suggested that OTS delete the reference to "monthly" billing in § 545.34(b) (now incorporated into § 560.33), inasmuch as some creditors offer bi-weekly or other mortgage plans. OTS is adopting this suggestion and deleting the word "monthly" from the final rule in order to afford institutions and consumers more flexibility in structuring payment plans.

Section 545.35 Other Real Estate Loans

Section 545.35 set forth federal savings associations' authority to lend and invest in nonresidential real estate subject to certain statutory and regulatory limitations. Paragraph (a) required compliance with real estate lending standards. Paragraph (b) reiterated the statutory limit of 400 percent of an association's total capital imposed on investments in nonresidential real estate. Pursuant to its streamlining efforts, OTS proposed to delete this section, incorporate the reference to federal savings associations' statutory authority to invest in nonresidential real estate into the lending and investment powers chart, and place related limitations into an accompanying endnote. OTS received no comments on § 545.35 and is making the changes proposed.

Section 545.36 Loans To Acquire or To Improve Real Estate

OTS proposed to delete § 545.36, which set forth regulatory investment limitations pertaining to acquisition, development, and construction loans. The one commenter addressing this proposed change supported OTS's view that the interagency real estate lending standards and interagency safety and soundness standards dealt with the same issues in a more comprehensive and current manner. Accordingly, OTS is deleting this section as proposed. OTS intends to incorporate paragraphs (c) and (d) of § 545.36 into the Handbook to provide guidance beyond that contained in the interagency real estate lending standards to thrifts making development loans.

Section 545.37 Combination Loans

OTS is deleting § 545.37 as proposed. This section allowed thrifts to combine sequentially different types of loans authorized by Part 545 and made at different stages of a project, with the term of each loan beginning at the end of the previous loan. This provision was useful when OTS regulations limited the number of years for which certain types of loans could be made. OTS removed those restrictions in 1992. OTS believes this section is therefore no longer necessary. The sole commenter addressing this section supported its deletion.

Section 545.38 Insured and Guaranteed Loans

Paragraphs (a) and (b) of § 545.38 authorized federal thrifts to make insured and guaranteed residential real estate loans, notwithstanding other provisions of Part 545 but subject to certain limitations. OTS proposed deleting these paragraphs as unnecessary. Federal savings associations may make an unlimited percentage of residential real estate loans, subject to the interagency real estate lending standards. Other regulatory restrictions have already been removed or are being deleted from Part 545 today. OTS received no comments on these proposed deletions, which are adopted as proposed.

Paragraph (c) addressed nonresidential real estate loans that are guaranteed by the Economic Development Administration, the Farmers Home Administration, or the Small Business Administration. OTS proposed deleting this paragraph and incorporating the HOLA's statutory grant of authority for federal thrifts to make guaranteed nonresidential real estate loans in the endnotes to the lending and investment powers chart. The sole commenter addressing § 545.38 supported deletion of the section as unnecessary and duplicative of the interagency real estate lending standards.

Accordingly, OTS is deleting this paragraph as proposed and incorporating the statutory reference into the lending and investment powers chart.

Section 545.39 Loans Guaranteed Under the Foreign Assistance Act of 1961

OTS proposed deleting § 545.39, which reiterated the HOLA's grant of authority n10 to federal thrifts to make loans guaranteed under the Foreign Assistance Act, n11 and incorporating its provisions into the lending and investment powers chart. OTS received no comments on this section. OTS is incorporating the provisions of § 545.39 into the lending and investment powers chart and endnotes and new § 560.43.

n10 *12 U.S.C. 1464*(c)(4)(C).

n11 *22 U.S.C. 2181*, 2184.

Section 545.40 Loans on Low-Rent Housing

OTS proposed to delete § 545.40, which exempted loans made pursuant to certain low rent housing programs of the Department of Housing and Urban Development from regulatory maximum loan term and loan-to-value limitations. OTS believes that this section is unnecessary because the loan term and loan-to-value ratio limitations referred to in the section have already been or are now being removed from OTS regulations. The one commenter who addressed this section supported its elimination. Accordingly, OTS is deleting this section as proposed. By deleting this section, OTS does not intend to limit federal thrifts' authority to make low-rent housing loans pursuant to applicable statutory and regulatory provisions, but rather to remove obsolete restrictions that only serve to confuse those using OTS's regulations.

Section 545.41 Community Development Loans and Investments

OTS proposed to delete § 545.41 because it simply reiterated the HOLA's grant of authority to federal savings associations to make direct community development loans and investments, subject to an overall five percent of assets limitation. n12 OTS received no comments on this proposed change. OTS is deleting this section as proposed and incorporating the statutory authority reference into the lending and investment powers chart.

n12 *12 U.S.C. 1464*(c)(3)(B).

Section 545.42 Home Improvement Loans

Section 545.42 reiterated the HOLA's grant of authority to federal thrifts to make home improvement loans subject to prudent lending standards. n13 OTS **[*50957]** proposed deleting this section and incorporating the reference to federal thrifts' statutory authority to make home improvement loans into the lending and investment powers chart. OTS received no comments on § 545.42 and is making the proposed changes.

n13 *12 U.S.C. 1464*(c)(1)(J).

Section 545.43 State Housing Corporation Investment-Insured

OTS proposed to delete § 545.43 because it reiterated the HOLA's grant of authority to federal thrifts to invest in state housing corporation loans n14 subject to a regulatory 30 percent of assets limitation. This section also duplicates restrictions in current § 563.95, which regulates investment in state housing corporations for all savings associations. n15 OTS received no comments on this section. OTS is deleting § 545.43, as proposed, including the 30 percent of assets limitation. The reference to the HOLA's grant of authority to federal thrifts to invest in state housing corporation loans has been incorporated into the lending and investment powers chart.

n14 *12 U.S.C. 1464*(c)(1)(P).

n15 Section 563.95, as discussed later, is being modified and moved into new Part 560.

Section 545.44 Mortgage Transactions With the Federal Home Loan Mortgage Corporation

Section 545.44 provided, in accordance with HOLA section 5(c)(1)(E) and the Federal Home Loan Mortgage Corporation Act, that federal thrifts may enter into or perform mortgage transactions with Freddie Mac. It did not impose any additional regulatory restrictions. OTS proposed to delete this section as an unnecessary reiteration of statutory authority and of savings associations' inherent power to enter into business contracts. The sole commenter addressing § 545.44 supported its deletion as unnecessary. OTS is deleting § 545.44 as proposed. HOLA section 5(c)(1)(E) is now referenced in the lending and investment powers chart.

Section 545.45 Manufactured Home Financing

OTS proposed to delete paragraph (a) of § 545.45, which contained definitions relating to manufactured home financing. The proposed deletion of other paragraphs of this section made these definitions unnecessary. OTS received no comments on this paragraph and is deleting it as proposed.

OTS proposed to delete paragraph (b) of § 545.45, which reiterated the HOLA's grant of authority to federal thrifts to invest in or make manufactured home loans. n16 The two commenters addressing this section supported these streamlining efforts, and OTS is deleting paragraph (b) as proposed. OTS is incorporating the statutory reference to federal thrifts' authority to invest in manufactured home loans into the lending and investment powers chart.

n16 *12 U.S.C. 1464*(c)(1)(J).

Paragraphs (c) and (d) of § 545.45 addressed inventory financing and retail financing for manufactured home chattel paper and established term and loan-to-value limits for such loans. OTS proposed deleting these paragraphs because they describe underwriting standards for manufactured homes that are more suitable as guidance. The two commenters addressing these paragraphs supported removing loan-to-value and maximum term limits on manufactured homes to eliminate micromanagement of the lending process. Accordingly, OTS is deleting these paragraphs as proposed.

However, the commenters disagreed as to the extent to which these paragraphs should be transferred to the Handbook. One commenter suggested that underwriting guidance in the Handbook pay particular attention to the unique risk characteristics associated with manufactured home financing. The second commenter believed that limitations in the Handbook would not necessarily produce better manufactured home loan performance but rather would only limit credit availability for low and medium income borrowers and leave thrifts at a competitive disadvantage with regard to other types of institutions. This commenter contended that a prudent underwriting program that balanced creditworthiness and payment capacity of a borrower along with product parameters, pricing differentials, and reserve requirements provided a better means for managing risk than a program containing strict limits on particular factors. n17 OTS will review these suggestions prior to issuing any guidance regarding mobile home lending.

n17 This commenter also suggested expanding the definition of residential property in existing § 563.101 (now § 560.101) of the interagency real estate lending standards to include manufactured homes placed on real property regardless of whether the home is permanently affixed as determined by state law. The OTS believes that modifying the substance of that section, which was developed on an interagency basis, is not within the scope of this rulemaking and defers consideration of this suggestion until a later date.

OTS proposed to delete paragraph (e) of § 545.45, which provided that a federal thrift's sale of manufactured home chattel paper must be sold without recourse. Since that paragraph was first adopted, OTS has adopted a capital regulation that requires thrifts to hold appropriate levels of capital against all sales with recourse. n18 OTS received no comments on this proposed change and is deleting paragraph (e) as proposed.

n18 See *12 CFR 567.1(kk), 567.6(a)(2)(i)(C).*

Section 545.46 Commercial Loans

OTS proposed to delete paragraph (a) of § 545.46, which simply reiterated the HOLA's grant of authority to federal thrifts to invest in and make commercial loans not to exceed 10 percent of their assets. n19 OTS also proposed to incorporate the authority and statutory limitation in paragraph (a) into the lending and investment powers chart. Commenters generally supported these proposed changes, which are adopted as proposed.

n19 *12 U.S.C. 1464*(c)(2)(A). The language in § 545.46(a) regarding pre-1984 investment limits is obsolete and has been deleted.

OTS also proposed deleting paragraph (b), which defined commercial loans to include commercial overdrafts related to demand accounts and commercial unsecured loans by service corporations. OTS proposed to incorporate paragraph (b)(1) (commercial overdrafts) into an endnote to the lending and investment powers chart. OTS received no comments on this proposed change, which is adopted as proposed.

OTS also proposed to remove the requirement that commercial loans made at the service corporation level be aggregated with the 10 percent of assets limit on commercial lending. Commenters generally agreed with OTS's view that the statutory maximum aggregate 3 percent of assets that federal savings associations may invest in service corporations n20 generally provides a sufficient safeguard for savings associations investing in service corporations engaged in commercial lending as it does for all other types of activities conducted in service corporations. Under the current regulations, only a service corporation's commercial loans are aggregated with its parent's loans for purposes of statutory percentage-of-assets limitations on general investment authority, while other service corporation investments are not. n21 Most commenters agreed with **[*50958]** OTS that such a distinction is not warranted and that such loans should no longer be subject to the 10 percent of assets limitation on commercial lending set forth in HOLA section 5(c)(2)(A).

n20 *12 U.S.C. 1464*(c)(4)(B).

n21 12 CFR 545.74(c)(1)(1996). For purposes of some other regulations, such as loans to one borrower (12 CFR 563.93, to be recodified at *12 CFR 560.93*) and transactions with affiliates (*12 CFR 563.41* and 563.42), investments at the service corporation level are aggregated with investments of the parent savings association. This final rule does not affect those regulatory provisions.

These commenters also agreed that by removing this aggregation requirement federal thrifts will be afforded modest additional flexibility to expand their commercial lending. This incremental enhancement of thrifts' lending authority will benefit both thrifts and their customers, without endangering safety and soundness or thrifts' primary mission of providing mortgage lending.

One bank trade association commenter did express a concern that removing the requirement to aggregate commercial loans made by a service corporation with its parent's loans might circumvent the HOLA ceiling on commercial loans. However, the HOLA does not require that a service corporation's commercial loans be aggregated with its parent's loans for purposes of statutory percentage-of-assets limitations on general investment authority. Service corporations do not fall within the definition of savings association for purposes of applying HOLA's investments limits. As noted above, the HOLA imposes an aggregate limit on investments in service corporations of 3 percent of assets, but does not impose sublimits on service corporation investments. The FHLBB's original inclusion of a service corporation's commercial loans within its parent savings association's commercial lending authority was done in 1983 when commercial lending was a new activity for savings associations. Given the levels of capital now required for such loans and OTS's experience in regulating this activity, OTS believes that allowing this modest increase in commercial lending authority is appropriate. OTS therefore will follow the plain statutory language of HOLA sections 5(c)(2)(A) and 5(c)(4)(B), which do not require aggregation of a service corporation's commercial loans with those made by its parent.

Section 545.47 Overdraft Loans

OTS proposed to delete § 545.47, because it simply reiterated the HOLA's grant of authority to federal thrifts to make loans specifically related to transaction accounts, including overdraft loans. OTS also proposed to incorporate the reference to federal thrifts' statutory authority to make overdraft loans into the lending and investment powers chart accompanied by an endnote specifying that commercial overdraft loans formerly covered by § 545.46 remain subject to the same commercial lending limits. OTS received no comment on these proposed changes, which are adopted as proposed.

Section 545.48 Letters of Credit

Section 545.48 authorized federal thrifts to issue letters of credit in conformance with the Uniform Commercial Code or the Uniform Customs and Practices for Documentary Credits and subject to certain general standards. As already discussed, the HOLA expressly authorizes federal thrifts to invest in or make loans, and this express authorization to make loans necessarily includes within it the authority to make loan commitments and issue letters of credit. For ease of reference, OTS proposed to reference the authority of federal thrifts to issue letters of credit in the lending and investment powers chart. OTS also proposed to incorporate the substance of § 545.48(a) into new § 560.120 as prudent standards for the issuance of letters of credit. OTS solicited comment on whether transferring the substance of § 545.48(a) to the new Part 560 would provide needed uniform standards for all savings associations.

The two commenters to address this section both supported OTS's efforts to update § 545.48 to reflect current market standards and industry usage for letters of credit. Both commenters also supported OTS's adoption of regulatory requirements for the issuance of letters of credit for all savings associations in order to provide uniform standards for all thrifts. While applauding OTS's efforts to modernize its letters of credit regulation, however, one commenter contended that the specific language of the proposed rule was not crafted to address some of the regulatory issues raised by contemporary letters of credit practice. This commenter suggested that OTS review the most recent interpretive ruling on letters of credit issued by the OCC, which was published after OTS issued its notice of proposed rulemaking. n22

n22 See Interpretive Ruling: Independent Undertakings To Pay Against Documents (*12 CFR 7.1016*) *(61 FR 4849, 4852-3, 4865,* February 9, 1996, effective April 1, 1996).

Having reviewed the OCC's interpretive ruling, OTS has determined to substantially adopt the approach taken by the OCC with respect to the regulation of letters of credit. OTS believes that the OCC ruling incorporates many of the modern market standards and industry usage applicable to letters of credit. Furthermore, by substantially adopting the OCC's approach, OTS is acting consistent with Section 303 of the CDRIA, which encourages the federal banking agencies to move towards greater uniformity in regulations on common supervisory issues.

In its February 9, 1996 ruling, the OCC treats letters of credit and independent undertakings as equivalent transactions for regulatory purposes. The OCC uses the term "independent undertakings" to encompass letters of credit as well as all such unilateral commitments under which a bank's obligation to honor its commitment is dependent solely on the proper presentation of specified documents regardless of extrinsic factors (except fraud, forgery, or an overriding public policy issue). n23 As the OCC points out, the term "independent undertakings" is used by the United Nations Commission on International Trade Law to cover a broad array of transactions including commercial letters of credit, standby letters of credit, and other undertakings that are functionally identical or equivalent to letters of credit. n24

n23 See Notice of Proposed Rulemaking: Interpretive Rulings, *60 FR 11924, 11926* (March 3, 1995).

n24 *61 FR at 4852.*

The new § 560.120 states that a thrift may issue and commit to issue letters of credit. The new section also allows thrifts to issue and commit to other independent undertakings approved by OTS. OTS also believes that, in the thrift context, the broad scope of the term "independent undertaking" and its recent evolution require closer supervision of such transactions when they fall outside the more traditional activities generally known as letters of credit. National banks have traditionally been more involved in international banking transactions and may be more familiar than most thrifts with nontraditional activities that fall within the term "independent undertakings". OTS believes that allowing thrifts to issue independent undertakings of a type specifically approved by OTS strikes the appropriate balance between giving thrifts greater flexibility to potentially engage in new types of transactions while at the same time ensuring that thrifts have properly evaluated the risks posed by a particular transaction consistent with prudent banking practice. OTS anticipates that its approval may take the form of legal opinions, general guidance, or case-by-case approvals, depending upon how the undertakings are presented to the agency. **[*50959]**

Paragraph (a) of the new § 560.120 explains that a savings association may issue and commit to issue a letter of credit or other approved independent undertaking. Paragraph (a) also provides a non-exclusive list of sample laws and rules of practice n25 and explains that non-documentary conditions on the thrift's undertaking are not relevant to the thrift's obligation to honor its commitment.

n25 See footnote to the new § 560.120(a).

Paragraph (b) of the final rule requires that thrifts evaluate certain safety and soundness factors when issuing letters of credit and approved independent undertakings. Paragraph (b) also requires that thrifts possess the operational expertise commensurate with the sophistication of their letter of credit and independent undertaking activities. The final rule also permits a thrift to issue a letter of credit or other approved undertaking without an express expiration date, provided that the thrift retains the right not to renew the transaction and to cancel the transaction upon notice to the parties.

OTS also proposed to delete paragraph (b) of § 545.48, which addressed the treatment of funds advanced under a letter of credit without compensation from the account party, because it duplicates § 545.31(b), which OTS proposes to incorporate into § 560.31(a). OTS received no comment on this proposed deletion, which is adopted as proposed.

Because issuing a letter of credit is not in and of itself a loan or investment, the reference to letters of credit has been removed from the lending and investment powers chart. When a savings association advances funds under the terms of a letter of credit or independent undertaking, those funds will then constitute a loan and will be counted toward the appropriate HOLA section 5(c) investment category.

Section 545.49 Loans on Securities

OTS proposed to delete § 545.49, which simply reiterated the HOLA's grant of authority to federal thrifts to invest in loans to financial institutions and brokers secured by obligations backed by the United States government or certain agencies or instrumentalities thereof. n26 OTS also proposed to incorporate a reference to thrifts' statutory authority to invest in such loans secured by U.S. government or agency-backed obligations into the lending and investment powers chart. The agency also proposed to remove as unnecessary the introductory paragraph limiting permissible investments in agencies or instrumentalities of the United States to those entities named in § 566.1(g)(3). OTS received no comments on this section and accordingly deletes this section as proposed.

n26 *12 U.S.C. 1464*(c)(1)(L).

Section 545.50 Consumer Loans

Section 545.50 reiterates the HOLA's grant of authority to federal thrifts to make consumer loans subject to a 35 percent of assets limit. n27 For purposes of determining compliance with this limit, federal thrifts must aggregate their consumer loans with any investments in corporate debt securities and commercial paper. n28 In other words, a federal thrift's aggregate investments in consumer loans, corporate debt securities, and commercial paper may not exceed 35 percent of its assets.

n27 *12 U.S.C. 1464*(c)(2)(D).

n28 *Id.*

OTS proposed to delete paragraph (a) of § 545.50 and to incorporate the reference to federal thrifts' statutory authority to make consumer loans, subject to the statutory asset limit, into the lending and investment powers chart. OTS also proposed to include an endnote incorporating the provisions of paragraph (c) of § 545.50, which addressed loans to dealers in consumer goods. Commenters were generally supportive of these changes and OTS is making the proposed changes.

OTS also solicited comment on how the definition of consumer loan set forth in paragraph (b) of § 545.50 could be clarified and coordinated with other OTS regulations that address consumer credit. Several commenters pointed out the inconsistency between paragraph (b)'s definition of "consumer loan," which expressly excludes credit cards, and § 561.12, which defines "consumer credit" to include credit cards. OTS recognizes the ambiguity that arises from the use of these similar, but not identical, terms in different regulatory provisions. For purposes of HOLA investment limits and Part 560, the term "consumer loan" will continue to be defined in the Definitions section, new § 560.3, as it has been in § 545.50. As part of a later Regulatory Structure rulemaking, OTS will consider how best to minimize or eliminate the potential for confusion presented by differing definitions of similar terms.

Under current OTS regulations, credit card loans are not subject to the 35 percent of assets investment limit applicable to consumer loans, corporate debt securities, and commercial paper. Section 545.51, discussed below, governs credit card activity of federal savings associations and imposes no percentage of assets limits on credit cards. This approach mirrors the HOLA. HOLA section 5(b)(4) authorizes federal thrifts to invest in consumer loans, corporate debt securities, and commercial paper subject to a 35 percent of assets limit is separate from the statutory provision that authorizes thrifts to invest in credit cards. The statutory provision authorizing credit cards contains no percentage of assets limit. The legislative history does not provide any clear guidance regarding whether any linkage was intended. The sole commenter addressing this issue agreed with OTS's position that the plain language of the HOLA imposes no percentage of assets limit on credit card operations.

The final rule carries forward the structure of OTS's existing regulations. Under the final rule, "consumer loan" will continue to be defined in a manner that excludes credit card loans. Thus, credit card loans are not subject to the 35 percent of assets limit on consumer loans. However, the regulation notes, at endnote 5 to § 560.30, that OTS may impose a case-by-case limit on this or any type of lending activity if the association's concentration in such investments presents a safety and soundness concern.

Section 545.51 Credit Cards

OTS proposed to delete paragraph (a) of § 545.51, which reiterated the HOLA's grant of statutory authority to federal thrifts to engage in credit card operations. n29 OTS proposed to incorporate a reference to federal savings associations' statutory authority to engage in credit card operations into the lending and investment powers chart. OTS received no comments on this paragraph and adopts these changes as proposed.

n29 *12 U.S.C. 1464*(b)(4).

OTS also proposed to delete paragraph (b) of § 545.51, which addressed the confidentiality of personal security identifiers in conjunction with credit card operations, because it is redundant with the provisions of the Electronic Funds Transfer Act and Regulation E. n30 The one commenter addressing this paragraph supported this reasoning. OTS is deleting this paragraph as proposed.

n30 See *15 U.S.C. 1693 et seq.* and 12 CFR Part 205 respectively.

Section 545.52 Loans on Savings Accounts

OTS proposed to delete § 545.52, which reiterated the HOLA's grant of authority to federal thrifts to make loans **[*50960]** on the security of savings accounts and sets forth regulatory limits on such loans. n31 OTS proposed to incorporate the reference to federal thrifts' statutory authority to make loans on savings accounts into the lending and investment powers chart and retain the limitation on such loans to the withdrawal amount of the savings account as an endnote to the chart. OTS received no comments on this section and the proposed changes to § 545.52 are adopted as proposed.

n31 *12 U.S.C. 1464*(c)(1)(A).

Section 545.53 Finance Leasing

Paragraph (a) of § 545.53 authorized federal thrifts to engage in various leasing activities that are the functional equivalent of lending, subject to certain regulatory limitations. n32 OTS proposed to reference federal thrifts' finance leasing authority in the proposed lending and investment powers chart, with an endnote cross-referencing applicable regulatory limitations. OTS received no comment on this proposed change, which is adopted as proposed.

n32 Section 545.53 cited several HOLA lending provisions, *12 U.S.C. 1464* (c)(1)(B), (c)(2)(A), and (c)(2)(D), as the basis for federal thrifts' finance leasing authority.

OTS also proposed to consolidate the finance leasing requirements of § 545.53 with the general leasing requirements of § 545.78 into one streamlined section, new § 560.41. In connection with this consolidation, OTS proposed to delete the term limits for finance leases and to increase the minimum residual value requirement for finance leases from 20 to 25 percent. The one commenter addressing these proposed changes supported the proposed consolidation and agreed with OTS's reasoning that institutions should be free to establish their own term limits based on prudent underwriting criteria and market conditions. The commenter also supported the increase in residual value requirement because it enhanced the flexibility of thrifts' leasing operations. Because of the complexity of leasing activities, this commenter also suggested that OTS provide clear underwriting guidance for various types of leasing activities in the Handbook as well as additional examiner training on leasing arrangements. A second commenter requested a clearer definition of "full-payout lease" in § 560.41(c).

In this final rule, OTS is consolidating its leasing regulations into the newly adopted § 560.41. The section has been revised to clarify its scope and definitions. OTS is also eliminating the term limits and increasing the minimum residual value requirement for finance leases to 25 percent. OTS notes that the OCC allows national banks to make finance leases with a residual value of 25 percent of the original cost of the property to the lessor. n33 OTS plans to add underwriting guidance to the Handbook addressing leasing arrangements.

n33 The OCC has recently proposed amendments to its leasing regulation at *60 FR 46246* (September 6, 1995).

OTS is also consolidating the salvage powers provisions in § 545.53 into the new § 560.41. Paragraph (e) of that new section outlines a thrift's salvage powers on all types of leases.

Section 545.72 Government Obligations

Section 545.72 reiterated the HOLA's grant of authority to federal thrifts to invest in obligations of any state, territory, or political subdivision thereof. n34 OTS proposed to delete this section and incorporate the reference to federal thrifts' statutory authority to invest in government obligations into the lending and investment powers chart. OTS also proposed incorporating the provisions of § 545.72(a) regarding investments in obligations meeting investment grade requirements into a new § 560.42 entitled "State and local government obligations." The lending and investment powers chart would cite the new § 560.42 in its endnotes. OTS received no comments on these proposed changes, which are adopted as proposed.

n34 *12 U.S.C. 1464*(c)(1)(H).

In order to encourage additional sound community-related investments, OTS also proposed modifying regulatory restrictions in § 545.72(b) before their incorporation into the new § 560.42. OTS proposed to clarify that the 1 percent of assets limitation for investments in obligations of a state or political subdivision where a savings association has its home or a branch office that do not meet the rating or full faith and credit requirements of § 545.72(a) is an aggregate limit. However, OTS also proposed to allow savings associations to invest additional amounts in such obligations, without geographic restrictions, if the obligation is specifically approved for investment by OTS.

The two commenters addressing this section supported OTS's reasoning that this change would afford savings associations additional flexibility to invest in government obligations without any threat to the associations' safety and soundness. One commenter noted that the obligations of local municipalities often are rated noninvestment grade or are unrated, yet these communities could benefit from local savings associations' increased investment in municipal bonds. Both commenters believed that thrifts with strong capital, sound underwriting standards, and broadly diversified investment portfolios should have the discretion to invest in government obligations. One commenter argued that OTS should not require prior approval before an association is permitted to invest in government obligations in a locality in which the association does not have a home or branch office. OTS, however, believes that such prior approval is appropriate because the purchase of noninvestment grade or unrated obligations is potentially risky, and associations should be prepared to demonstrate that their decision to invest in such obligations does not pose any threat to the association's safety or soundness.

OTS believes that the proposed changes will give savings associations additional flexibility while still allowing the agency to monitor the risks presented by investments in government obligations. The proposed rule gives thrifts the option to invest in unrated government securities, exceed the 1 percent of assets limit for unrated securities of localities where the thrift has an office, or invest in obligations in localities where they do not have an office if the thrifts obtain prior OTS approval. Accordingly, OTS adopts the proposed modifications to paragraphs (a) and (b) of § 545.72 and incorporates those modified provisions into the new § 560.42.

OTS also proposed to remove the restriction on gold-related obligations contained in paragraph (c) of § 545.72 as obsolete. OTS received no comment on the proposed deletion, which is adopted as proposed.

Section 545.73 Inter-American Savings and Loan Bank

Section 545.73 reiterated federal savings associations' authority to invest in the share capital and capital reserve of the Inter-American Savings and Loan Bank, subject to statutory and regulatory limitations on the amount of investment. n35 OTS proposed to remove this section and incorporate this authority and limitations into the new lending and investment powers chart, endnotes, and new § 560.43, which addresses foreign assistance investments. OTS received no comment on these proposed changes, which are adopted as proposed.

n35 *12 U.S.C. 1464*(c)(4)(C). **[*50961]**

Section 545.74 Service Corporations

OTS proposed, as discussed under § 545.46 above, to no longer aggregate commercial loans made by a savings association's service corporation with commercial loans made by the savings association itself for purposes of the statutory 10 percent of assets limitation. The agency proposed a conforming change to § 545.74(c)(1)(vi), where this regulatory aggregation is repeated. The remaining provisions of § 545.74 are currently under separate review as part of the agency's reinvention of its subsidiaries regulations. n36 The one commenter specifically addressing the conforming change to § 545.74 supported excluding any commercial loan booked by a service corporation from the 10 percent commercial loan limit for federal savings associations. The commenter noted, as did the OTS proposal, that this modification would make the treatment of commercial loans owned by service corporations consistent with the treatment of noncommercial loans owned by service corporations. Accordingly, OTS has modified this paragraph as proposed.

n36 See Notice of Proposed Rulemaking, Subsidiaries and Equity Investments, *61 FR 29976* (June 13, 1996).

Section 545.75 Commercial Paper and Corporate Debt Securities

Section 545.75(a) reiterated the HOLA's grant of authority to federal thrifts to invest in commercial paper and corporate debt securities. n37 OTS proposed to delete this paragraph and to reference federal thrifts' statutory authority to invest in commercial paper and corporate debt securities in the lending and investment powers chart. The agency also proposed to retain the limitations on these investments contained in paragraphs (b) and (c) and to move them into the new § 560.40 on commercial paper and corporate debt securities in Part 560. n38

n37 *12 U.S.C. 1464*(c)(2)(D).

n38 The agency also solicited comment on whether these provisions should, alternatively, be removed from the regulations and incorporated as guidance in the Handbook.

The only commenter to address this section questioned why paragraph (b) requires a thrift's investments in commercial paper and corporate debt securities to be denominated in dollars. OTS agrees with this commenter's position that the HOLA, *12 U.S.C. 1464*(c)(2)(D), does not require such denomination, and previous OTS opinions have stated that such investments are permissible as long as foreign currency risks are properly hedged. Accordingly, OTS adopts § 560.40 as proposed with the modification that commercial paper and corporate debt securities are no longer required to be denominated in dollars.

OTS also proposed to delete paragraph (d) of § 545.75 as no longer having any practical application for thrifts in light of § 28(d) of the Federal Deposit Insurance Act n39 (FDIA). Paragraph (d) authorized a federal savings association to invest in commercial paper and corporate debt securities not meeting the rating and marketability requirements of paragraphs (b) and (c), so long as such investments are not otherwise prohibited by § 28(d) of the FDIA, which prohibits investments by thrifts in unrated corporate bonds. Although OTS solicited comment as to whether there was any scenario under which an investment authorized by paragraph (d) would not violate § 28(d) of the FDIA, OTS received no responsive comments. Because OTS believes that paragraph (d) has no practical application for thrifts, it is deleting paragraph (d) as proposed.

n39 *12 U.S.C. 1831e*(d).

Section 545.78 Leasing

Paragraph (a) of § 545.78 reiterated the HOLA's grant of authority to federal thrifts to invest in tangible personal property for leasing purposes. n40 OTS proposed to incorporate a reference to this statutory authority into the proposed lending and investment powers chart. As already discussed under § 545.53 earlier, OTS also proposed to consolidate the general leasing restrictions applicable to federal savings associations in § 545.78 with the finance leasing restrictions in § 545.53 into a new § 560.41. The one commenter addressing these proposed changes supported the consolidation, and OTS is adopting these changes as proposed.

n40 *12 U.S.C. 1464*(c)(2)(C).

OTS also proposed to delete paragraph (b) of § 545.78, which imposes a maximum 70 percent residual value limit for general leasing activities. OTS believes that such an underwriting restriction may be unduly restrictive if applied in all cases and that such lease underwriting considerations are better addressed within each association's prudent leasing policies, which will be subject to review by OTS examiners. Furthermore, OTS plans to provide underwriting guidance on leases in its Handbook. The one commenter addressing this section supported the proposed deletion because it would give additional flexibility to thrifts in structuring lease arrangements. The commenter also suggested that additional underwriting guidance be included in the Handbook because of the complexity of leasing activities.

OTS is deleting the maximum 70 percent residual value limit as proposed and replacing that requirement with more flexible underwriting guidance in the Handbook. As discussed earlier under § 545.53, the new § 560.41 addresses both general leasing and finance leasing authority.

Section 556.2 Power To Engage in Escrow Business

Section 556.2 addressed federal thrifts' power to engage in the escrow business. OTS proposed to delete this policy statement, because OTS believes that the authority to establish escrow accounts is subsumed within the authority of federal savings associations to make loans and does not need to be specifically identified in the CFR. See discussion above with regard to § 545.32(b)(6). Although one commenter supported the proposed elimination of this section as unnecessary, a second commenter raised a concern that elimination of this section might raise preemption concerns. For the reasons discussed above with regard to § 545.32(b)(6), OTS believes that a thrift's power to establish escrow accounts does not need to be specifically identified in the CFR. Furthermore the new preemption regulation at § 560.2 specifically cites escrow accounts as an area in which state law is preempted. Accordingly, OTS is deleting § 556.2, as proposed.

Section 556.3 Real Estate

Section 556.3(a) addressed the treatment of motels as either improved nonresidential real estate or combination home and business property for real estate categorization purposes. OTS proposed to delete this paragraph and incorporate it into guidance. Section 556.3(b) permitted federal thrifts to purchase paving certificates that constitute a lien on property securing an association's loan. OTS proposed to delete this section and transfer the language of the policy statement to the Handbook. OTS received no comment on these proposed deletions, which are adopted as proposed.

Section 556.10 First Liens on Properties Sold by the Secretary of HUD

Section 556.10 reiterated federal thrifts' authority to make mortgage loans insured by the Federal Housing Administration and secured by first liens on improved real estate and discussed the treatment and documentary evidence of such loans after disposal by the Secretary of **[*50962]** Housing and Urban Development. OTS proposed to delete this policy statement and move it to guidance in the Handbook. OTS received no comment on this proposed deletion, which is adopted as proposed.

Section 563.93 Lending Limitations

Section 563.93 contained lending limits on all loans and extensions of credit made by all savings associations and their subsidiaries. This section and its accompanying Appendix are being redesignated and moved unchanged into new Part 560 as § 560.93, for ease of reference.

Section 563.95 Investment in State Housing Corporations

Section 563.95 covered investments in or loans to state housing corporations by all savings associations. It imposed certain conditions, including percentage-of-asset limitations, depending on the type of loan or investment and the savings association's capital level. OTS proposed to modify and update this section and move it into a new § 560.121 in new Part 560.

Paragraph (a) dealt with loans to, and investments in obligations of, state housing corporations that are secured, directly or indirectly, by first liens on federally insured improved real estate. OTS proposed to remove percentage-of-asset investment limitations in this paragraph (a). Commenters supported OTS's reasoning that removing the percentage-of-assets limit would allow thrifts to exercise business judgment in determining the amount they wished to invest in such loans and obligations, subject, as always, to overall safety and soundness considerations.

OTS proposed to update the language in paragraph (b), which covers investments in obligations of state housing corporations that do not fall under paragraph (a), in several ways. First, the agency proposed to remove the outdated limitation based on a thrift's level of "general reserves surplus and undivided profits." Instead, any thrift that is adequately capitalized under 12 CFR Part 565 may make such investments. Second, OTS proposed to allow investments under paragraph (b) to be made in obligations of state housing corporations located in any state in which the association has its home or a branch office. Third, OTS proposed to revise the aggregate limit on such investments to equal a thrift's total capital under 12 CFR Part 567 (rather than its general reserves, surplus, and undivided profits) and to move this requirement into a new paragraph (b)(2). Finally, the agency proposed to delete the requirement that a thrift may make no more than 25 percent of its aggregate investment in this type of obligation in the obligations of any one state housing corporation. This requirement effectively required an institution to invest in four state housing corporations any time it wished to invest in one.

Commenters believed that revisions to restrictions on investments in state housing corporations would encourage institutions to make additional sound community related investments. Savings associations' increased participation in community-related investments could potentially benefit communities and their affordable housing programs without undermining thrifts' safety and soundness. Commenters also agreed that elimination of the 25 percent limit on investments to a single state housing corporation should cause no problem because thrifts will be protected by the cap on aggregate investments and by examiners' asset concentration review. One commenter urged OTS to go further and make additional revisions, such as allowing thrifts to invest in obligations of state housing corporations throughout the country, not just where the thrift has a home or branch office. This commenter also suggested removing the aggregate cap on total investments, subject to OTS approval, under certain circumstances. OTS, however, believes that the proposed regulatory language strikes the appropriate balance between giving thrifts additional flexibility with respect to investment in state housing corporations and ensuring safe and sound operations. Accordingly, OTS adopts the proposed revisions to paragraphs (a) and (b) of § 563.95 and incorporates those revisions into the new § 560.121.

The agency also proposed to delete existing paragraph (c), which allows thrifts (that otherwise have the legal authority to do so) to make direct equity investments in equity securities of state housing authorities. Federal thrifts currently do not have authority to invest in equity securities of state housing corporations, and section 28 of the FDIA constrains state chartered thrifts from making, or retaining past July 1, 1994, any equity investment not permissible for federal thrifts. n41 Although OTS solicited comment as to whether there was any scenario under which paragraph (c) was still relevant, no commenters responded to this request. OTS deletes paragraph (c) of § 563.95 as proposed.

n41 See *12 U.S.C. 1831e*(c), which states that a state chartered savings association "may not directly acquire or retain any equity investment of a type or in an amount that is not permissible for a Federal savings association," with a limited exception for service corporation investments.

The agency proposed to move paragraph (d), substantially unchanged, into new § 560.121 as paragraph (c). This paragraph addresses a thrift's obligation, before making an investment in a state housing corporation, to obtain the corporation's agreement to make information available to OTS upon request. OTS received no comment on this provision which is adopted as proposed.

Section 563.97 Loans in Excess of 90 Percent of Value

OTS proposed to delete § 563.97, which authorized thrifts to make loans on the security of residential real estate with loan-to-value ratios in excess of 90 percent of value, consistent with the interagency real estate lending standards. Commenters agreed that the interagency real estate lending standards address the same issue in a more comprehensive manner. OTS is deleting § 563.97 as proposed.

Section 563.99 Fixed-Rate and Adjustable-Rate Mortgage Loan Disclosures, Adjustment Notices, and Interest Rate Caps

Section 563.99 defined fixed and adjustable-rate mortgage loans and required thrifts to make certain disclosures to applicants of adjustable-rate mortgage loans. In order to establish parity in coverage with other lenders, OTS proposed to add a new paragraph (g) to exclude from § 563.99's coverage adjustable-rate loans that are primarily for a business, commercial, or agricultural purpose, consistent with the Federal Reserve Board's (FRB) Truth in Lending regulation, Regulation Z. n42

n42 Regulation Z exempts from its disclosure requirements extensions of credit primarily for business, commercial, or agricultural purposes. *See 12 CFR 226.3(a)(1)*.

Commenters generally favored making § 563.99's coverage consistent with that of Regulation Z. Section 563.99 covered all adjustable-rate loans with a term of more than one year, secured by property occupied or to be occupied by the borrower. Unlike § 563.99, Regulation Z's coverage is not determined by the nature of the secured property but rather by other criteria, *e.g.*, the extension of credit must be primarily for personal, family, or household purposes. n43 As the regulations interacted, certain transactions were encompassed by § 563.99 but not by Regulation Z. By adopting the proposed changes to § 563.99, OTS will be minimizing the differences between that section and Regulation Z. For example, a savings **[*50963]** association that makes a business purpose ARM loan secured by a home will no longer be subject to the disclosure requirements set forth at § 563.99; nor would any disclosures be required under Regulation Z.

n43 *12 CFR 226.1(c)(1)(iv)*.

Several commenters recommended deleting the disclosure portions of § 563.99 in their entirety because those provisions were duplicative of Regulation Z. Commenters argued that two sets of disclosure regulations confused lenders and required them to search two places to figure out applicable regulatory requirements. OTS will undertake a comprehensive review of § 563.99 in conjunction with the FRB's review of Regulation Z pursuant to section 303 of the CDRIA. n44 Pending that review, § 563.99 is being redesignated as § 560.210, so that all lending regulations will be grouped together in Part 560. The only changes being made to § 563.99 are changing its title to be more descriptive of its content, adding a new paragraph (g), as discussed above, and removing paragraph (a)(2), which defined "fixed rate mortgage loan," a term not used in the regulation. OTS does note that the disclosure requirements of current § 563.99 and Regulation Z n45 are substantially similar.

n44 Pursuant to section 303(b) of the CDRIA, the FRB is required to review its regulations with respect to disclosures pursuant to the Truth In Lending Act with regard to adjustable-rate mortgages in order to simplify the disclosures, if necessary, and make the disclosures more meaningful and comprehensible to consumers. *12 U.S.C. 4803.*

n45 See *12 CFR 226.19(b), 226.20(c).*

Section 563.100-563.101 Real Estate Lending Standards

These sections prescribed real estate lending standards that require all savings associations to adopt and maintain comprehensive written real estate lending policies that are consistent with safe and sound practices and with the Guidelines for Real Estate Lending. n46 Savings associations' policies must address certain lending considerations including loan-to-value limits, loan administration procedures, portfolio diversification standards, and documentation, approval, and reporting requirements. OTS did not propose changes to these sections, but indicated its intent to redesignate and move them substantially unchanged into a new Part 560. OTS received no comment on these proposed redesignations and is redesignating them as §§ 560.100-560.101 in the final rule issued today. The Appendix containing the guidelines is also being redesignated.

n46 Appendix A to the real estate lending standards at current §§ 563.100-101.

Section 563.160 Classification of Certain Assets

Section 563.160 required thrifts to classify their own assets and establish valuation allowances. OTS proposed to delete this section in its entirety. n47 The one commenter addressing this section favored its deletion and suggested placing classification guidance in the Handbook. This commenter noted that the section's deletion would be consistent with the stance of the other banking agencies which set forth their asset classification systems as supervisory guidance, not as regulations.

n47 OTS had already requested comment on deleting the definitions of "Substandard," "Doubtful," and "Loss" set forth in paragraph (b) and the definition of "Special Mention" assets in paragraph (e) because definitions of those terms are contained in the Handbook. *58 FR 38730* (July 20, 1993). Commenters supported such deletions. The OTS proposed deleting paragraph (f) as part of its regulatory review proposal, *60 FR 44442* (August 28, 1995), and received no unfavorable comments.

Upon further consideration, OTS has decided to retain a short classification regulation simply stating that a savings association must have an internal system to classify assets and must establish appropriate valuation allowances or charge-offs, as appropriate. OTS believes that retaining a short classification regulation at new § 560.160 will ensure that a thrift's board of directors takes responsibility for monitoring its classification system. OTS will transfer more detailed guidance concerning asset classification to the Handbook consistent with the supervisory guidance of the other federal banking agencies.

Section 563.170 Examinations and Audits; Appraisals; Establishment and Maintenance of Records

Paragraph (a) of § 563.170 authorizes OTS to examine thrifts consistent with OTS policies and to annually assess thrifts for the costs of such examinations based on the thrifts' assets. OTS proposed to retain this paragraph. The agency received no comment on this section, which is retained as proposed in its current location.

Paragraph (b) authorizes OTS to select appraisers to perform appraisals of real estate in connection with examinations and audits and requires thrifts to pay for such appraisal services. OTS proposed to retain this paragraph. The agency received no comment on this section, which is also retained as proposed.

Paragraph (c) sets forth general record maintenance requirements for savings associations to ensure that examiners have access to an accurate and complete record of all business transacted by the thrift. OTS proposed to retain this general introductory paragraph, with a modification to incorporate language in current paragraph (c)(9) on maintaining records required by other laws or regulations.

Paragraphs (c) (1)-(9), however, set forth a list of specific loan documents that, at a minimum, thrifts must maintain to comply with § 563.170(c). OTS proposed replacing the specific documentation requirements listed in paragraphs (c)

(1)-(9) with more general documentation standards in a new § 560.170 in Part 560. These proposed standards were drawn from the interagency Standards for Safety and Soundness regulations and attached Guidelines Establishing Standards for Safety and Soundness. n48 These guidelines set forth loan documentation and credit underwriting requirements to which all federal insured depository institutions are expected to adhere. These underwriting and documentation standards minimize the need for OTS to have a regulation mandating specific documentation requirements. n49

n48 12 CFR Part 570 and Appendix A thereto, *60 FR 35674* (July 10, 1995).

n49 Guidelines appended to the interagency real estate lending standards also state that an institution should establish loan administration procedures that address documentation. See 12 CFR Part 563, Subpart D, Appendix A (redesignated in this rulemaking as Appendix to § 560.101).

Commenters unanimously supported OTS's proposal to eliminate the detailed list of documents required in paragraphs (c) (1)-(9). Commenters agreed with OTS's reasoning that although the documents listed were generally appropriate for prudent lending, a rigid requirement that all documents be present for each loan was too restrictive and did not necessarily address all safety and soundness concerns. Commenters believed that elimination of the specific document list would give lenders more flexibility to tailor loan documentation to various types of loans and to determine which particular documents would be most appropriate for a specific loan.

For example, previously § 563.170(c)(1)(v) required either a financial statement or a credit report for all loans, ostensibly to justify the borrower's willingness and ability to repay the loan. However, the ability and willingness of a borrower to repay a consumer or home loan may be better demonstrated with a verification of employment (not previously required) and a satisfactory credit report, rather than a financial statement. For commercial borrowers, verification by **[*50964]** the institution that the borrower's financial statements accurately reflect all assets, liabilities, and any other guarantees or encumbrances is more important to the decision to extend credit than the mere presence of a financial statement. The more flexible language of new § 560.170 will allow thrifts to obtain documentation that best satisfies safety and soundness concerns raised in a particular transaction, while at the same time relieving thrifts of the burden of technical compliance with a document checklist that may not necessarily be relevant to prudent lending.

Commenters also agreed that deleting paragraphs (c) (1)-(9) would relieve savings associations of documentation requirements that exceed those for banks and other financial institutions as well as enable savings associations to take better advantage of technological marketplace advances such as telephone and computerized home banking. New § 560.170 will allow savings associations to participate in telephone and computerized home banking without running afoul of paper driven-requirements. Accordingly OTS adopts the changes to § 563.170(c) as proposed.

In its proposal, OTS also considered transferring the current document list in paragraphs (c) (1)-(5), and (7) to the Handbook to be used as a checklist of records generally maintained by prudent lenders to support a loan. Several commenters raised concerns regarding the language of the guidance that would be included in the Handbook. One commenter urged that if OTS includes a document list in the Handbook, the agency should also clearly state that the list is intended only as guidance and not as rigid minimum requirements for safety and soundness. The commenter suggested inserting language to the effect that the lender (based on borrower creditworthiness, the specific program and product offering, pricing, project delinquency, loss profile, and title and appraisal information) should have the discretion not to require certain documents in any given situation. Another commenter recommended deletion of the requirement that loan documents identify a purpose for the loan because lines of credit are now used for any purpose, the identification of which is not necessary to proper underwriting. The interagency guidelines establishing standards for safety and soundness do state that a lender should identify the purpose of a loan. n50 However, OTS will review these comments prior to issuing any loan documentation guidance to be included in the Handbook.

n50 *60 FR at 35679.*

Paragraph (c)(10) of § 563.170 exempted certain small business loans from the documentation requirements set forth in paragraphs (c) (1)-(7). OTS proposed to delete paragraph (c)(10) inasmuch as the streamlining of the requirements currently located in paragraphs (c) (1)-(7) eliminates the need for this exemption. OTS received no comment on this paragraph, which is deleted as proposed.

OTS proposed to retain paragraph (d) of § 563.170, which addresses changes in the location of accounting or control records. One commenter questioned whether advances in computer technology rendered this paragraph obsolete since computerized accounting and control records could be accessed at many locations. Although OTS recognizes that computerized records may be read from computer terminals in many locations, OTS believes that the agency may need to know the location of the server where computer records are physically stored for examination purposes. Accordingly, OTS is retaining this paragraph as proposed.

OTS proposed to retain paragraph (e), which addresses use of data processing services for maintenance of records. One commenter suggested that all but the last sentence of this paragraph could be eliminated inasmuch as maintenance of records by means of data processing services has become the norm and requiring a thrift to notify the Region in which its principal office is located of such maintenance creates unnecessary paperwork. Although OTS agrees that thrifts routinely maintain records by means of data processing services, the agency believes that this paragraph serves the purpose of requiring institutions to identify the particular records to be maintained by a data processing service and the location where such records are maintained. This information may be critical to an examination or enforcement inquiry. Accordingly, OTS is retaining this paragraph as proposed.

To summarize, § 563.170 is being modified as proposed, by removing the specific loan documentation requirements of paragraphs (c) (1) through (10) and by retaining the remainder of the regulation. The specific loan documentation requirements have been replaced by more general lending documentation requirements in new § 560.170.

Section 563.172 Reevaluation of Real Estate Owned

Section 563.172 required savings associations to appraise all real estate owned (REO) at the earlier of in-substance foreclosure or at the time of acquisition and, thereafter, as dictated by prudent management policy. In its proposal OTS discussed deleting this section because thrifts can apply the appraisal regulations and general accounting principles (GAAP) to determine when an appraisal may be appropriate or necessary for safety and soundness. Two commenters supported elimination of this section to give lenders more flexibility with regard to the timing of an appraisal for property soon to become REO. Commenters agreed, however, that it is sound policy to require an appraisal for REO. Upon consideration, OTS has decided to retain this regulation to specify when, at a minimum, safety and soundness require an appraisal of REO. Accordingly, it is incorporating § 563.172 unchanged into the new Part 560 as new § 560.172.

Section 571.8 Investment in State Housing Corporations

Section 571.8 limited savings associations' investment authority in state housing corporations to certain public and private corporations and agencies. OTS proposed to delete this policy statement as an unnecessary limitation on the definition of state housing corporation. The one commenter to address this section supported its deletion. OTS is deleting § 571.8 as proposed.

Section 571.13 Participation Interests in Pools of Loans

Section 571.13 addressed appropriate documentation for a savings association's purchase of a participation interest in a pool of loans (in the nature of mortgage-backed securities) and indicated that compliance with the documentation requirements of § 563.170 may be impracticable for such transactions. OTS proposed to delete this section inasmuch as the proposed revision of § 563.170(c) would eliminate the need for this policy statement. OTS received no comment on this section, which is deleted as proposed. OTS plans to transfer the documentation guidance for purchases of participation interests in pools of loans to the Handbook.

Section 571.20 Payment for Appraisals

OTS proposed to delete § 571.20, which addressed payment by savings associations for appraisals obtained as part of an OTS examination. OTS received no comment on this section, which is deleted as proposed. OTS expects to transfer this policy statement to the Handbook. **[*50965]**

Section 571.22 Most Favored Lender Status

Section 571.22 implemented section 4(g) of the HOLA, which authorizes savings associations to charge on any extension of credit an interest rate equal to the greater of: (a) One percentage point above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve district in which the savings association is located; or (b) the rate allowed by the laws of the State in which the savings association is located for the state's most favored lender. OTS proposed to move § 571.22 into new § 560.2(d)(1) and requested comment on whether certain provisions in § 571.22 should be modified. Because HOLA section 4(g) and this regulation apply to all savings associations, however, § 571.22 is being moved to a new § 560.110, "Most Favored Lender, Usury Preemption" in Subpart B of Part 560, which applies to all savings associations. Changes to the text of the regulation are discussed under § 560.110 below.

2. New Part 560-Lending and Investment

OTS proposed to adopt a new Part 560, Lending and Investment, that would ultimately include all of the agency's lending and investment regulations except for Appraisals (Part 564) and subsidiary-related investments (currently proposed to be located in new Part 559). Commenters generally agreed with OTS's view that this reorganization will make it much easier for those using the agency's regulations to find all relevant lending and investment powers, authorities, and limitations. Accordingly, OTS is adopting new Part 560 as discussed below.

Section 560.1 General

This section sets out the basic statutory authority for lending and indicates which regulations in this part will apply only to federal savings associations and which regulations apply to all savings associations. It also briefly sets forth the agency's expectations that all lending and investment activities are to be conducted prudently, consistent with safety and soundness, with adequate portfolio diversification, and in a manner appropriate for the size of the institution, the nature and scope of its operations, and conditions in its lending market. OTS received no comment on this section, which is adopted as proposed, with minor clarifications.

Section 560.2 Applicability of Law

This section sets forth OTS's longstanding position, as developed in case law and legal opinions by both OTS and its predecessor, the FHLBB, and as reflected in § 545.2, on the federal preemption of state laws affecting the lending activities of federal savings associations. Because the agency proposed to move its lending regulations out of Part 545 and, thus, separate them from its general preemption regulation, § 545.2, and because the agency proposed to remove many of the details of the lending regulations that had been previously cited in preemption opinions, OTS also proposed new § 560.2 to confirm and carry forward its existing preemption position.

It is well established that state laws can be preempted not only by federal statutes, but also by federal regulations promulgated pursuant to authority delegated by Congress. n51 In this regard, the Supreme Court has recognized that Congress gave the regulator of federal savings associations broad preemptive authority:

n51 *Fidelity Federal Savings & Loan Association v. de la Cuesta, 458 U.S. 141, 153-154 (1982).*

Congress enacted the HOLA [as] "a radical and comprehensive response to the inadequacies of the existing state systems * * *." Thus, in section 5(a) of the [HOLA], Congress gave the [FHLBB and now the OTS] plenary authority to issue regulations * * * "providing for the * * * incorporation, examination, operation, and regulation of [federal savings] associations * * *."

Congress directed that, in regulating federal [savings associations], the [FHLBB and OTS should] consider "the best practices of local mutual thrift and home financing institutions in the United States," which were at the time all state-chartered. By so stating, Congress plainly envisioned that federal savings [associations] would be governed by what the [FHLBB and now OTS]-not any particular state-deemed to be the best practices, and approved the [FHLBB's and OTS's] promulgation of regulations superseding state law * * *. n52

n52 *Id. at 160-167* (citations omitted).

Consistent with the foregoing, courts have long recognized that federal savings associations organized under the HOLA are uniquely federalized financial institutions-even more so than national banks. n53 Prior to enactment of the HOLA, " the states had developed a hodgepodge of savings and loan laws and regulations, and Congress hoped the [the FHLBB, and now OTS] rules would set an example for uniform and sound savings and loan regulation.'" n54

n53 *People v. Coast Federal Savings & Loan Association, 98 F. Supp. 311, 319 (S.D. Calf. 1951).*

n54 *Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979)* (citation omitted).

Thus, OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to: (i) Facilitate the safe and sound operation of federal savings associations, (ii) enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or (iii) further other purposes of the HOLA. Because lending lies at the heart of the business of a federal thrift, OTS and its predecessor, the FHLBB, have long taken the position that the federal lending laws and regulations occupy the entire field of lending regulation for federal savings associations, leaving no room for state regulation. For these purposes, the field of lending regulation has been defined to encompass all laws affecting lending by federal thrifts, except certain specified areas such as basic real property, contract, commercial, tort, and criminal law.

As a result, instead of being subject to a hodgepodge of conflicting and overlapping state lending requirements, federal thrifts are free to originate loans under a single set of uniform federal laws and regulations. This furthers both the "best practices" and safety and soundness objectives of the HOLA by enabling federal thrifts to deliver low-cost credit to the public free from undue regulatory duplication and burden. At the same time, the interests of borrowers are protected by the elaborate network of federal borrower-protection statutes applicable to federal thrifts, including the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Consumer Leasing Act, the Fair Debt Collection Practices Act, the Community Reinvestment Act, and the Federal Trade Commission Act. n55 In addition, in those instances **[*50966]** where OTS has detected a gap in the federal protections provided to borrowers, the agency has promulgated regulations imposing additional consumer protection requirements on federal thrifts. n56

n55 Several of these statutes contain provisions that expressly disclaim any intent to preempt non-conflicting state statutes falling in the same subject area. *E.g., 12 U.S.C. 2616* (Real Estate Settlement Procedures Act); and *15 U.S.C. 1610* (Truth in Lending Act). The fact that one or several federal statutes do not preempt certain types of state laws, however, does not preclude the possibility that other federal statutes or regulations might do so under more defined or specific circumstances. In this regard, it is important to note that the above-referenced federal statutes that contain preemption disclaimers apply to all types of lenders (including state-chartered lenders), not just federal savings associations. The fact that Congress did not wish to preempt the application of state laws to this general universe of lenders (including lenders chartered and regulated by the very states whose laws would be preempted), does not preclude the possibility that Congress may have elsewhere evidenced a specific intent to preempt, or permit a federal regulator to preempt, the application of state laws to a particular category of lender-in this case, federal savings associations. This is precisely the conclusion reached by the court in *First Federal Savings & Loan Association v. Greenwald, 591 F.2d 417 (1st Cir. 1979).* There, the court held that OTS's predecessor, the FHLBB, was authorized by Congress in the HOLA to preempt state lending laws even when they fall in areas covered by the preemption disclaimer in the Real Estate Settlement Procedures Act. We believe the court's holding reflects a correct understanding of the interplay between the HOLA and the above-referenced statutes, as evidenced by the legislative history of the HOLA. See, *e.g.*, 124 Cong. Rec. 33848 (Statement of Rep. Minish); 124 Cong. Rec. 36148 (1978) (colloquy between Sen. Proxmire and Sen. Brooke confirming that federal thrifts are not subject to state truth in lending requirements); 124 Cong. Rec. 33848-33849 (statement of Rep. St Germain to the same effect); and 126 Cong. Rec. 6981 (1980) (colloquy between Rep. St Germain and Rep. Patterson confirming that thrifts, unlike national banks, are not subject to state lending laws).

n56 See, *e.g.*, 12 CFR Part 535 (prohibited consumer credit practices) and new §§ 560.33 (late charges), 560.34 (prepayments), and 560.35 (adjustments to home loans).

New § 560.2 carries forward this approach to federal preemption. Although the final form of regulation is similar to what was proposed, some changes have been made in response to comments received. Several commenters expressed concern that the statement in proposed § 560.2(a) that OTS intended to occupy the entire field of lending regulation for federal thrifts would not be sufficient to restrain state regulators from asserting jurisdiction, given that OTS was also proposing to remove some of its more detailed regulatory language specifically authorizing federal thrifts to engage in various lending-related practices, *e.g.*, advertising, charging certain fees, and establishing escrow accounts. One commenter suggested that OTS expand its noninclusive illustrative list of the types of state laws preempted to reference additional laws, such as those pertaining to private mortgage insurance or other credit enhancements, loan servicing, charging application and overlimit fees, establishing impound and similar accounts, using credit reports, and setting certain interest rate ceilings. Other commenters echoed these concerns.

In response to commenters' concerns, OTS has made some changes to § 560.2. Paragraph (a) still explicitly states the agency's intent to occupy the field of lending regulation for federal thrifts. However, the statutory bases and regulatory rationale for this occupation are more clearly articulated. In addition, to avoid any impression that the repeal of certain lending regulations is intended to abdicate portions of the lending field to state regulation, we have added an affirmation that, "OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation."

Paragraph (b) contains an expanded list of examples of the types of state laws that are preempted. The introductory text in paragraph (b) continues to emphasize that the list is not intended to be exhaustive. Failure to mention a particular type of state law that affects lending should *not* be deemed to constitute evidence of an intent to permit state laws of that type to apply to federal thrifts. To the contrary, § 560.2 is based on the premise that any state law that affects lending is preempted unless it clearly falls within the parameters of paragraph (c).

Paragraph (b) also continues to contain an exception clause indicating that certain state laws that would not ordinarily apply to federal savings associations may nevertheless apply when an association elects to utilize a state's most favored lender usury rate. When utilizing a state's most favored lender rate, a federal savings association must comply with all laws of its "location" state that fall within the ambit of the term "interest," as used in section 4(g) of the HOLA, as well as any other state laws "material to the determination of the interest rate." For a fuller discussion of these issues, see the description below of new § 560.110 (most favored lender).

Paragraph (c) describes certain types of state laws that OTS does not intend to preempt. Several commenters urged deletion of this paragraph. Commenters expressed concern that states seeking to avoid federal preemption of their laws or regulations might attempt to characterize those laws as falling within paragraph (c). Commenters contended that the language used to describe the categories of non-preempted laws was too broad and could create ambiguity about which state laws federal thrifts would be required to follow. For example, states might place laws purporting to regulate lending-related fees in the portions of state codes dealing with general contract or real property laws in an effort to avoid preemption.

OTS believes that paragraph (c) should be retained in order to provide guidance regarding the scope of preemption intended by paragraph (a). OTS wants to make clear that it does not intend to preempt basic state laws such as state uniform commercial codes and state laws governing real property, contracts, torts, and crimes. To reduce the potential for misunderstanding, however, we have made several changes to paragraph (c). First, we have modified the regulatory language that precedes the list of state laws that are not preempted. The introductory language now indicates that laws falling in these areas are not preempted to the extent that they either: (i) Have only an incidental impact on lending; or (ii) are otherwise not contrary to the purposes expressed in paragraph (a) of the regulation. We also have added a provision to paragraph (c) disclaiming an intent to preempt other state laws that may affect lending, but that OTS, upon review, finds further a vital state interest and meet the foregoing two-part test.

Adding this two-part test to the regulation will provide an interpretive standard for identifying state laws that may be designed to look like traditional property, contract, tort, or commercial laws, but in reality are aimed at other objectives, such as regulating the relationship between lenders and borrowers, protecting the safety and soundness of lenders, or pursuing other state policy objectives.

When confronted with interpretive questions under § 560.2, we anticipate that courts will, in accordance with well established principles of regulatory construction, look to the regulatory history of § 560.2 for guidance. In this regard, OTS wishes to make clear that the purpose of paragraph (c) is to preserve the traditional infrastructure of basic state laws that undergird commercial transactions, not to open the door to state regulation of lending by federal savings associations. When analyzing the status of state laws under § 560.2, the first step will be to determine whether the type of law in question is listed in paragraph (b). If so, the analysis will end there; the law is preempted. If the law is not covered by paragraph (b), the next question is whether the law affects lending. If it does, then, in accordance with paragraph (a), the presumption arises that the law is preempted. This presumption can be reversed only if the law can clearly be shown to fit within the confines of paragraph (c). For these purposes, paragraph (c) is intended to be interpreted narrowly. Any doubt **[*50967]** should be resolved in favor of preemption.

As questions arise, OTS will issue interpretive guidance consistent with the foregoing. While recognizing that no regulation can anticipate and expressly resolve all questions, we believe that new § 560.2 provides thrifts with substantially more guidance than was available under § 545.2, thereby enabling them to plan and operate their lending operations more efficiently. From time to time, OTS will review, update, and modify § 560.2 to ensure that it reflects new developments and promotes "best practices" and safety and soundness.

Paragraph (d) of proposed § 560.2 was derived from former § 571.22. It is being adopted as § 560.110, incorporating the modifications described earlier under that section.

Section 560.3 Definitions

This new section has been added to set forth in Part 560 lending-related definitions formerly located in Part 545.

Subpart A--Lending and Investment Powers for Federal Savings Associations

This subpart contains lending and investment regulations directly applicable only to federal savings associations. These regulations are nonetheless relevant to state-chartered savings associations by virtue of § 28 (a) and (b) of the FDIA and the Federal Deposit Insurance Corporation's regulations at *12 CFR 303.13*, which look to the type and amount of activities permissible for federal savings associations as a baseline for activities permitted for state-chartered savings associations.

Section 560.30 General Lending and Investment Powers

Proposed § 560.30 took the form of a chart that listed many of the lending and investment powers granted to federal thrifts by the HOLA. It was derived from the regulations that currently appear in Part 545. An important component of this regulation are the endnotes to the chart that elaborate upon statutory limitations, impose regulatory limitations, or otherwise describe conditions on the exercise of these powers.

Commenters generally found the chart to be a very workable reference tool, particularly for percentage of assets limitations for specific types of loans and investments. Commenters believed that the chart form with its statutory cross references made it easier for the CFR user to locate statutory authority for various types of loans and investments. At least one commenter suggested that the chart would be more useful if it were more inclusive and listed additional statutory and regulatory lending and investment powers. Accordingly, OTS is adopting the lending and investment powers chart in the final rule in a more inclusive form with additional references to thrifts' statutory powers with regard to bankers' bank stock, business development credit corporations, unsecured construction loans, deposits, securities issued by the Federal government and government-sponsored enterprises, HUD-insured or guaranteed investments, insured loans, liquidity investments, mortgage-backed securities, nonconforming loans, the National Housing Partnership Corporation and related partnerships and joint ventures, and small business-related securities. n57 Other references in the chart on community development and letters of credit have been modified or removed so that the chart more clearly reflects lending and investment powers specifically authorized by the statute.

n57 As part of its subsidiaries and equity investment proposal, OTS has requested comment on other additions to this chart, affecting service corporations, certain open-end management investment companies, and small business investment companies. *61 FR at 29981.*

Section 560.31 Election Regarding Categorization of Loans or Investments and Related Calculations

This section is derived from current § 545.31, incorporating the modifications described earlier under that section.

Section 560.33 Late Charges

This section is derived from current § 545.34(b). It has been modified as discussed under that section.

Section 560.34 Prepayments

This section is derived from current § 545.34(c). The first sentence of that section has been rewritten to make it easier to understand, but no substantive change is intended. Advanced payments of regular installments are not considered prepayments for purposes of this regulation, as compared to payments to reduce the principal balance due on a loan.

Section 560.35 Adjustments to Home Loans

This section is derived from current § 545.33(c) and has been modified as discussed under that section.

Section 560.40 Commercial Paper and Corporate Debt Securities

This section is derived from paragraphs (b) and (c) of current § 545.75. It has been modified as discussed under that section.

Section 560.41 Leasing

This section consolidates and reorganizes current § 545.53 (finance leasing) and § 545.78 (general leasing authority), incorporating the modifications described under those sections. It has been reorganized to clarify the separate sources of authority and requirements that apply to these two types of leasing.

Section 560.42 State and Local Government Obligations

This section is derived from § 5(c)(1)(H) of the HOLA and paragraphs (a) and (b) of current § 545.72. It is being adopted as proposed.

Section 560.43 Foreign Assistance Investments

This section is a consolidation and reorganization of current §§ 545.39 and 545.73.

Subpart B--Lending and Investment Provisions Applicable to All Savings Associations

This subpart contains safety and soundness based lending standards and provisions applicable to all savings associations, including state savings associations, to the extent that they have the authority to make the investments it discusses.

Section 560.93 Lending Limitations

This section, including its appendices, has been moved, with only technical conforming changes, from § 563.93.

Section 560.100 Real Estate Lending Standards; Purpose and Scope

This section has been transferred without change from § 563.100.

Section 560.101 Real Estate Lending Standards

This section and the accompanying appendix have been transferred with only technical and conforming changes, from § 563.101 and Part 563, Subpart D, Appendix A.

Section 560.110 Most Favored Lender Usury Preemption

This section implements section 4(g) of the HOLA. Section 4(g) provides that, notwithstanding any contrary state law, savings associations may charge interest on any extension of credit at a rate equal to the greater of: (a) One percentage **[*50968]** point above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve district in which the savings association is located; or (b) the rate allowed by the laws of the state in which the savings association is located for the state's most favored lender, *i.e.*, the class of state lending institution authorized to charge the highest interest rate. Section 560.110 replaces § 571.22, which is being removed today.

In its January proposal, OTS restated the text of § 571.22, with several changes intended to eliminate unnecessary verbiage. However, OTS also solicited comment regarding whether paragraph (b) of the regulation should be modified to conform more closely to the OCC's most favored lender regulation.

Paragraph (b) of § 571.22 indicated that any savings association electing to make loans at the interest rate authorized for a state most favored lender must also comply with the same "substantive state law requirements" that are applicable to that state lender when making loans of the same type. The OCC interpretive regulation, which implements a parallel statutory provision for national banks, uses a slightly different phrase to describe what types of state laws must be complied with pursuant to the most favored lender doctrine. The OCC requires national banks to comply with all state laws that apply to the state most favored lender and are "material to the determination of the interest rate" authorized under state law. n58 OTS has previously opined that this standard is similar, though not identical, to OTS's "substantive law" standard. n59 OTS specifically requested comment regarding whether paragraph (b) of § 571.22 should be replaced in its entirety with a reference to state laws that are "material to the determination of the interest rate."

n58 12 CFR 7.7310 (revised and recodified at *12 CFR 7.4001*, *61 FR at 4869).*

n59 OTS Op. Chief Counsel, Oct. 14, 1992.

Two commenters responding to this inquiry supported adoption of the OCC's regulatory language. The commenters believed that the OCC language is more precise and its adoption would promote parity and uniformity in the agencies' interpretations of most favored lender questions consistent with section 303 of the CDRIA.

A third commenter raised a concern that the OCC's provision ("material to the determination of the interest rate") was narrower in scope than OTS's substantive law standard. This commenter noted that OTS currently interprets substantive state law requirements to include disclosure laws. The commenter reasoned that by complying with federal disclosure laws and disclosure laws in the state where it is located, a thrift need not comply with disclosure laws in states where it is not located but where borrowers reside. The commenter argued that this approach helps thrifts to make interstate loans more efficiently under a single set of disclosures that comply with federal law and the law of state where it is located without having to comply with a multiplicity of state specific disclosure requirements.

Contrary to the commenter's concern, adopting the "materiality" standard will not subject federal thrifts to the disclosure laws of "non-location" states. New § 560.2(b)(9), discussed above, specifically indicates that state disclosure requirements do not apply to federal thrifts, except when required by § 560.110. Nothing in § 560.110 applies the disclosure laws of non-location states to federal savings associations. Under § 560.110, only the disclosure laws of the location state will ever apply. If the "substantive law" standard were carried forward, the disclosure laws of the location state would apply every time a thrift made a loan under the most favored lender doctrine. By contrast, if the "materiality" standard is adopted, the disclosure laws of the location state will apply only in those rare instances where those laws are material to the determination of the interest rate. Thus, in the interest of reducing regulatory burden and establishing greater uniformity, OTS has decided to adopt the "materiality" standard.

The debate about the "materiality" standard, however, raises a more general question about whether OTS should conform the entire text of its most favored lender regulation to the OCC regulation. In this regard, we note that the courts have recognized that, when enacting section 4(g) of the HOLA, Congress intended to give savings associations the same most favored lender status conferred upon national banks. n60 Thus, OTS and its predecessor, the FHLBB, have long looked to the OCC regulation and other precedent interpreting the national bank most favored lender provision for guidance in interpreting section 4(g) and OTS's implementing regulation. n61 But for the distinction discussed above regarding the "materiality" standard, differences between OTS and OCC regulations have been purely a matter of syntax, not substance.

n60 *Gavey Properties/762 v. First Financial Savings & Loan, 845 F.2d 519, 521 (5th Cir. 1988);* and 12 CFR 571.22 (1996).

n61 See, *e.g.,* OTS Op. Chief Counsel, Dec. 24, 1992, pp. 3-4.

In February of this year, after OTS had issued its proposal, the OCC amended and updated its most favored lender regulation. n62 The primary change was to add an express definition of the term "interest" that was consistent with past precedent. The Supreme Court recently upheld this definition as a reasonable construction of the statutory most favored lender provision for national banks. n63 Under the OCC's amended regulation, the term "interest" is defined to include, without limitation, numerical periodic rates, late fees, not sufficient funds fees, overlimit fees, annual fees, cash advance fees, and membership fees.

n62 *61 FR at 4869.*

n63 *Smiley v. Citibank (South Dakota), N.A., 116 S. Ct. 1730 (1996).*

Given the similarities between section 4(g) of the HOLA and the national bank most favored lender provision, OTS believes that the term "interest" as it appears in section 4(g) and OTS's implementing regulation should be interpreted in a manner consistent with the OCC regulation and the Supreme Court's decision, even if the new OTS regulation did not expressly define the term. n64

n64 This means, among other things, that when federal thrifts elect to make loans in reliance on the most favored lender rate of their location state, they must comply with any limits the location state imposes on the lending fees encompassed within the term "interest," notwithstanding § 560.2(b)(5). In all other circumstances, state restrictions on loan-related fees are preempted, as provided in § 560.2(b)(5).

Therefore, rather than perpetuate nonsubstantive differences in syntax that could create confusion, OTS has decided to conform new § 560.110 to the OCC regulation. We do not believe this results in any substantive change from former § 571.22, except for adoption of the "materiality" standard, discussed above. Conforming to the OCC regulation is consistent with the commenters' view that the OCC's syntax is clearer and more precise, and with the congressional command to move toward greater banking agency uniformity.

Section 560.120 Letters of Credit and Other Independent Undertakings To Pay Against Documents

This section is derived from current § 545.48 and establishes standards for letters of credit for all savings associations, incorporating the modifications discussed under that section. **[*50969]**

Section 560.121 Investments in State Housing Corporations

This section is derived from current § 563.95, incorporating the modifications described earlier under that section.

Section 560.160 Asset Classification

This section requires each savings association to have an internal system to classify its assets and to establish appropriate valuations or charge-offs, as appropriate. It replaces the more detailed regulation found at current § 563.160.

Section 560.170 Records for Lending Transactions

This section contains general loan documentation requirements based on the interagency safety and soundness standards and guidelines found at 12 CFR Part 570. It replaces the specific loan documentation requirements previously found at § 563.170(c) (1)-(10), and incorporates the modifications described earlier under that section.

Section 560.172 Reevaluation of Real Estate Owned

This section has been transferred, without change, from § 563.172.

Subpart C--Alternative Mortgage Transactions

This subpart contains rules applicable to alternative mortgages originated by federal and state savings associations and certain other state lenders.

Section 560.210 Disclosures for Adjustable-Rate Mortgage Loans, Adjustment Notices, and Interest-Rate Caps

This section has been transferred from § 563.99. It has been amended as discussed under that section and to remove a definition, "fixed rate mortgage loan," that is no longer used in the regulation.

Section 560.220 Alternative Mortgage Parity Act

This section (originally proposed as § 560.210) is derived from current § 545.33(f), "Notice of housing creditors regarding alternative mortgage transactions" and applies to state savings associations and certain other state-chartered lenders. OTS has observed that state housing creditors interested in engaging in alternative mortgage transactions could not easily locate § 545.33(f). Placing these provisions into a subpart specifically dealing with alternative mortgages will make them more accessible. The section has been streamlined and modified to remove cross-references to repealed provisions and to clarify the scope of federal lending regulations applicable to state housing creditors electing to originate loans under the Parity Act. While the proposal indicated that all of new Part 560 would be considered appropriate and applicable to the exercise of the authority under the Parity Act, the final rule has been revised to identify the appropriate sections with greater specificity. One commenter suggested adding language to clarify that this section does not limit the preemption of the imposition of state licensing requirements on federal associations. Because of modifications made to the final preemption regulation at § 560.2, OTS believes that the addition of this language is not necessary. States may not impose lending license requirements on federal thrifts.

III. Disposition of Existing Lending and Investment Regulations

Original provision	New provision	Comment
§ 545.31 (a),(b)	§§ 560.31(a), 560.3	Modified. Substance has been moved into § 560.31(a); definitions have been moved into § 560.3.

Original provision	New provision	Comment
§ 545.31 (c),(d)	§ 560.31 (b),(c)	Modified.
§ 545.32(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.32(b) (1),(2)		Removed.
§ 545.32(b) (3)-(6)		Removed, included as areas in which state law is preempted under § 560.2.
§ 545.32(c)	§ 560.3	Substantially unchanged.
§ 545.32(d)		Removed.
§ 545.33 Introductory paragraph	§ 560.3	Substantially unchanged.
§ 545.33(a)		Removed, included as area in which state law is preempted under § 560.2.
§ 545.33(b)		Removed.
§ 545.33(c) (1)-(3)	§ 560.35	Modified.
§ 545.33(c) (4),(5)		Removed.
§ 545.33 (d),(e)		Removed.
§ 545.33(f)	§ 560.220	Modified.
§ 545.34(a)	§ 560.2	Modified and reorganized.
§ 545.34(b)	§ 560.33	Modified.
§ 545.34(c)	§ 560.34	Modified.
§ 545.35	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.36		Removed. Paragraphs (c) and (d) to be incorporated into guidance.
§ 545.37		Removed.
§ 545.38 (a),(b)		Removed.
§ 545.38(c)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.39(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.39(b)	§ 560.43	Modified.
§ 545.40		Removed.
§ 545.41	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.42	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.43	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.44		Removed.
§ 545.45(a)		Removed.
§ 545.45(b)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.45 (c),(d)		To be incorporated into guidance.
§ 545.45(e)		Removed.
§ 545.46(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.46(b) introductory paragraph and (b)(1)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.46(b)(2)		Removed.

Original provision	New provision	Comment
§ 545.47	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.48(a)	§ 560.120	Significantly changed.
§ 545.48(b)		Removed.
§ 545.49	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.50(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.50(b)	§ 560.3	Substantially unchanged.
§ 545.50(c)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.51(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.51(b)		Removed.
§ 545.52	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.53(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.53 (b)-(d)	§ 560.41	Significantly changed.
§ 545.72 Introductory paragraph	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.72 (a),(b)	§ 560.42	Significantly changed.
§ 545.72(c)		Removed.
§ 545.73 Introductory paragraph	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.73 (a),(b)	§ 560.43	Modified.
§ 545.74 (c)(1)(vi)		Modified.
§ 545.75(a)	§ 560.30	Incorporated into lending and investment powers chart.
§ 545.75 (b),(c)	§ 560.40	Modified.
§ 545.75(d)		Removed.
§ 545.78	§ 560.30. See also § 560.41.	Significantly changed and incorporated into lending and investment powers chart.
§ 556.2		Removed.
§ 556.3		To be incorporated into guidance.
§ 556.10		To be incorporated into guidance.
§ 563.93	§ 560.93	Redesignated with no changes.
§ 563.95	§ 560.121	Significantly changed.
§ 563.97		Removed.
§ 563.99	§ 560.210	Redesignated and modified by removing paragraph (a)(2) and adding new paragraph (g).
§ 563.100	§ 560.100	Redesignated without change.
§ 563.101	§ 560.101	Redesignated without change.
§ 563.160	§ 560.160	Significantly changed.
§ 563.170 (a),(b)		Unchanged.
§ 563.170(c) introductory text		Modified.
§ 563.170 (c)(1)-(10)	§ 560.170	Significantly changed.
§ 563.170 (d),(e)		Unchanged.
§ 563.172	§ 560.172	Unchanged.

Original provision	New provision	Comment
§ 571.8		Removed.
§ 571.13		To be incorporated into guidance.
§ 571.20		To be incorporated into guidance.
§ 571.22	§ 560.110	Significantly changed.

IV. Administrative Procedure Act

This final rule results from the notice of proposed rulemaking OTS published on January 17, 1996. In addition to the regulatory language proposed in that notice, OTS is today redesignating, without substantive change, other lending-related regulations previously located in Part 563 into new Part 560. Pursuant to section 553(b) of the Administrative Procedure Act, OTS hereby finds that good cause exists not to publish those provisions for public notice and comment. They are merely being renumbered and grouped with other lending-related regulations for the convenience of users, thus public notice and opportunity to comment are unnecessary.

V. Paperwork Reduction Act of 1995

Respondents/recordkeepers are not required to respond to this collection of information unless it displays a currently valid OMB control number.

The recordkeeping requirements contained in *12 CFR 560.170* and *563.170* of this final rule have been submitted to and approved by the Office of Management and Budget under OMB Control No. 1550-0078 in accordance with the Paperwork Reduction Act of 1995 *(44 U.S.C. 3507*(d)).

In response to comments received, OTS has decided to adopt *12 CFR 560.35*, which was not part of the proposal. The reporting requirements contained in this section have been submitted to the Office of Management and Budget for review.

Comments on all aspects of these information collections should be sent to the Office of Management and Budget, Paperwork Reduction Project (1550), Washington, DC 20503 with copies to OTS, 1700 G Street, NW., Washington, DC 20552.

The recordkeeping requirements in this final rule are found in *12 CFR 560.35*, *560.170*, and *563.170*. The reporting and recordkeeping requirements set forth in this final rule are needed by OTS in order to supervise savings associations and develop regulatory policy. The likely recordkeepers are OTS-regulated savings associations. Start-up costs to respondents: None.

Records are to be maintained for the period of time respondent/recordkeeper owns the loan plus three years.

The burden estimates for new § 560.35 are as follows:

Estimated number of respondents: 120.

Estimated average annual burden hours per respondent: 1.

Estimated number of hours per response: 20 hours. **[*50971]**

Estimated number of total annual burden hours: 2,400 hours.

Start-up costs to respondents: None.

VI. Executive Order 12866

The Director of OTS has determined that this final rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866.

VII. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, OTS certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule does not impose any additional burdens or requirements upon small entities and reduces burdens on all savings associations. The regulations have been reorganized to group all lending regulations together in a single part, which will make the regulations easier to locate and use. A chart setting forth the lending and investment powers of savings associations, with accompanying statutory citations, will make it easier for small savings associations to determine the scope of their lending authority. Loan documentation requirements have been streamlined and should result in less paperwork for small associations holding low-dollar amount, non-complex, loans in their portfolios.

VIII. Unfunded Mandates Act of 1995

OTS has determined that the requirements of this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of more than $ 100 million in any one year. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

IX. Effective Date

Section 302 of CDRIA delays the effective date of regulations promulgated by the Federal banking agencies that impose additional reporting, disclosure, or new requirements to the first day of the first calendar quarter following publication of the final rule. OTS believes that CDRIA does not apply to this final rule because it imposes no new burden. It reduces regulatory burden in the lending and investment areas and provides added flexibility.

List of Subjects

12 CFR Part 545

Accounting, Consumer protection, Credit, Electronic funds transfers, Investments, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 556

Savings associations.

12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

12 CFR Part 566

Liquidity, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 571

Accounting, Conflicts of interest, Investments, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 590

Banks, banking, Loan programs-housing and community development, Manufactured homes, Mortgages, Savings associations.

Accordingly, and under the authority of *12 U.S.C. 1462a,* the Office of Thrift Supervision amends chapter V, title 12, Code of Federal Regulations, as set forth below.

PART 545--OPERATIONS

1. The authority citation for part 545 continues to read as follows:

Authority: *12 U.S.C. 1462a*, 1463, 1464, 1828.

§§ 545.31-545.43, 545.45-545.53 -- [Removed]

2. Sections 545.31 through 545.43 and 545.45 through 545.53 are removed.

§§ 545.72-545.73 -- [Removed]

3. Sections 545.72 and 545.73 are removed.

§ 545.74 -- [Amended]

4. Section 545.74 is amended by revising paragraph (c)(1)(vi) to read as follows:

§ 545.74 -- Service corporations.

* * * * *

(c) * * *

(1) * * *

(vi) Commercial loans and participations therein.

* * * * *

§ 545.75 -- [Removed]

5. Section 545.75 is removed.

§ 545.78 -- [Removed]

6. Section 545.78 is removed.

PART 556--STATEMENTS OF POLICY

7. The authority citation for part 556 continues to read as follows:

Authority: *5 U.S.C. 552*, 559; *12 U.S.C. 1464*, 1701j-3; *15 U.S.C. 1693*-1693r.

§§ 556.2, 556.3, 556.10 -- [Removed]

8. Sections 556.2, 556.3, and 556.10 are removed.

9. Part 560 is added to read as follows:

PART 560--LENDING AND INVESTMENT

Sec.

560.1 General.

560.2 Applicability of law.

560.3 Definitions.

Subpart A--Lending and Investment Powers for Federal Savings Associations

560.30 General lending and investment powers.

Authority: *12 U.S.C. 1462*, 1462a, 1463, 1464, 1701j-3, 1828, 3803, 3806; *42 U.S.C. 4106.*

§ 560.1 -- General.

(a) *Authority and scope*. This part is being issued by OTS under its general rulemaking and supervisory authority **[*50972]** under the Home Owners' Loan Act (HOLA), *12 U.S.C. 1462 et seq.* Subpart A of this part sets forth the lending and investment powers of Federal savings associations. Subpart B of this part contains safety-and-soundness based lending and investment provisions applicable to all savings associations. Subpart C of this part addresses alternative mortgages and applies to all savings associations.

(b) *General lending standards.* Each savings association is expected to conduct its lending and investment activities prudently. Each association should use lending and investment standards that are consistent with safety and soundness, ensure adequate portfolio diversification and are appropriate for the size and condition of the institution, the nature and scope of its operations, and conditions in its lending market. Each association should adequately monitor the condition of its portfolio and the adequacy of any collateral securing its loans.

§ 560.2 -- Applicability of law.

(a) *Occupation of field.* Pursuant to sections 4(a) and 5(a) of the HOLA, *12 U.S.C. 1463*(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or § 560.110 of this part. For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

(b) *Illustrative examples.* Except as provided in § 560.110 of this part, the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:

(1) Licensing, registration, 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;

(3) Loan-to-value ratios;

(4) The terms of credit, including amortization of loans and the deferral and capitalization of interest and adjustments to the interest rate, balance, payments due, 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) Loan-related fees, including without limitation, initial charges, late charges, prepayment penalties, servicing fees, and overlimit fees;

(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 and laws requiring creditors to supply copies of credit reports to borrowers or applicants;

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

(11) Disbursements and repayments;

(12) Usury and interest rate ceilings to the extent provided in *12 U.S.C. 1735f-7a* and part 590 of this chapter and *12 U.S.C. 1463*(g) and § 560.110 of this part; and

(13) Due-on-sale clauses to the extent provided in *12 U.S.C. 1701j-3* and part 591 of this chapter.

(c) *State laws that are not preempted.* State laws of the following types are not preempted to the extent that they only incidentally affect the lending operations of Federal savings associations or are otherwise consistent with the purposes of paragraph (a) of this section:

(1) Contract and commercial law;

(2) Real property law;

(3) Homestead laws specified in *12 U.S.C. 1462a*(f);

(4) Tort law;

(5) Criminal law; and

(6) Any other law that OTS, upon review, finds:

(i) Furthers a vital state interest; and

(ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.

§ 560.3 -- Definitions.

For purposes of this part:

Consumer loans include loans for personal, family, or household purposes and loans reasonably incident thereto, and may be made as either open-end or closed-end consumer credit, but do not include credit extended in connection with credit cards nor *bona fide* overdraft loans.

Home loans include any loans made on the security of homes (including a unit of a condominium or cooperative), combinations of homes and business property, farm residences, and combinations of farm residences and commercial farm real estate.

Loan commitment includes a loan in process, a letter of credit, or any other commitment to extend credit.

Real estate loan includes any loan for which a Federal savings association relies substantially upon the real estate as the primary security for the loan. A loan is made on the security of real estate if:

(1) The security property is real estate pursuant to the law of the state in which the property is located;

(2) The security interest of the Federal savings association may be enforced as a real estate mortgage or its equivalent pursuant to the law of the state in which the property is located;

(3) The security property is capable of separate appraisal; and

(4) With regard to a security property that is a leasehold or other interest for a period of years, the term of the interest extends, or is subject to extension or renewal at the option of the Federal savings association for a term of at least five years following the maturity of the loan.

Subpart A--Lending and Investment Powers for Federal Savings Associations

§ 560.30 -- General lending and investment powers.

Pursuant to section 5(c) of the HOLA, *12 U.S.C. 1464*(c), a Federal savings association may make, invest in, purchase, sell, participate in, or otherwise deal in (including brokerage or warehousing) all loans and investments allowed under section 5(c) of the HOLA including the following loans, extensions of credit, and investments, subject to the limitations indicated and any such clarifying terms, conditions, or case-by-case limitations **[*50973]** as may be prescribed from time to time by the Office by opinion, policy directive, order, or regulation:

Lending and Investment Powers Chart

Category	HOLA authorization	Statutory Investment Limitations (notes contain applicable regulatory limitations)
Bankers' bank stock	5(c)(4)(E)	Same terms as applicable to national banks.
Business development credit corporations	5(c)(4)(A)	The lesser of .5% of total outstanding loans or $ 250,000.
Commercial loans	5(c)(2)(A)	10% of total assets.
Commercial paper and corporate debt securities	5(c)(2)(D)	Up to 30% of total assets. fn1 fn2
Community development loans and equity investments	5(c)(3)(B)	5% of total assets, provided equity investments do not

Lending and Investment Powers Chart

Category	HOLA authorization	Statutory Investment Limitations (notes contain applicable regulatory limitations)
		exceed 2% of total assets. fn3
Construction loans without security	5(c)(3)(D)	In the aggregate, the greater of total capital or 5% of total assets.
Consumer loans	5(c)(2)(D)	Up to 35% of total assets. fn1 fn4
Credit cards	5(b)(4)	None. fn5
Deposits in insured depository institutions	5(c)(1)(G)	None. fn5
Education loans	5(c)(3)(A)	5% of total assets.
Federal government and government-sponsored enterprise securities and instruments	5(c)(1)(C) 5(c)(1)(D) 5(c)(1)(E) 5(c)(1)(F)	None. fn5
Finance leasing	5(c)(1)(B) 5(c)(2)(A) 5(c)(2)(B) 5(c)(2)(D)	Based on purpose and property financed. fn6
Foreign assistance investments	5(c)(4)(C)	1% of total assets. fn7
General leasing	5(c)(2)(C)	10% of assets. fn6
Home improvement loans	5(c)(1)(J)	None. fn5
Home (residential) loans fn8	5(c)(1)(B)	None. fn5 fn9
HUD-insured or guaranteed investments	5(c)(1)(O)	None. fn5
Insured loans	5(c)(1)(I) 5(c)(1)(K)	None. fn5
Liquidity investments	5(c)(1)(M)	None. fn5
Loans secured by deposit accounts	5(c)(1)(A)	None. fn5 fn10
Loans to financial institutions, brokers, and dealers	5(c)(1)(L)	None. fn5 fn11
Manufactured home loans	5(c)(1)(J)	None. fn5 fn12
Mortgage-backed securities	5(c)(1)(R)	None. fn5
National Housing Partnership Corporation and related partnerships and joint ventures	5(c)(1)(N)	None. fn5
Nonconforming loans	5(c)(3)(C)	5% of total assets.
Nonresidential real property loans	5(c)(2)(B)	400% of total capital. fn13
Small-business-related securities	5(c)(1)(S)	None. fn5
State and local government obligations	5(c)(1)(H)	None. fn5 fn14
State housing corporations	5(c)(1)(P)	None. fn5 fn15
Transaction account loans, including overdrafts	5(c)(1)(A)	None. fn5 fn16

Notes:

fn1 For purposes of determining a Federal savings association's percentage of assets limitation, investment in commercial paper and corporate debt securities must be aggregated with the Federal savings association's investment in consumer loans.

fn2 A Federal savings association may invest in commercial paper and corporate debt securities, which includes corporate debt securities convertible into stock, subject to the provisions of § 560.40 of this part.

fn3 The 2% of assets limitation is a sublimit for investments within the overall 5% of assets limitation on community development loans and investments. The qualitative standards for such loans and investments are set forth in HOLA section 5(c)(3)(B), as explained in an opinion of the OTS Chief Counsel dated May 10, 1995 (available upon request at the address set forth in § 516.1(a) of this chapter).

fn4 Amounts in excess of 30% of assets, in aggregate, may be invested only in loans made by the association directly to the original obligor and for which no finder's or referral fees have been paid. A Federal savings association may include loans to dealers in consumer goods to finance inventory and floor planning in the total investment made under this section.

fn5 While there is no statutory limit on certain categories of loans and investments, including credit card loans, home improvement loans, and deposit account loans, OTS may establish an individual limit on such loans or investments if the association's concentration in such loans or investments presents a safety and soundness concern.

fn6 A Federal savings association may engage in leasing activities subject to the provisions of § 560.41 of this part.

fn7 This 1% of assets limitation applies to the aggregate outstanding investments made under the Foreign Assistance Act and in the capital of the Inter-American Savings and Loan Bank. Such investments may be made subject to the provisions of § 560.43 of this part.

fn8 A home (or residential) loan includes loans secured by one-to-four family dwellings, multi-family residential property and loans secured by a unit or units of a condominium or housing cooperative.

fn9 A Federal savings association may make home loans subject to the provisions of §§ 560.33, 560.34 and 560.35 of this part.

fn10 Loans secured by savings accounts and other time deposits may be made without limitation, provided the Federal savings association obtains a lien on, or a pledge of, such accounts. Such loans may not exceed the withdrawable amount of the account.

fn11 A Federal savings association may only invest in these loans if they are secured by obligations of, or by obligations fully guaranteed as to principal and interest by, the United States or any of its agencies or instrumentalities, the borrower is a financial institution insured by the Federal Deposit Insurance Corporation or is a broker or dealer registered with the Securities and Exchange Commission, and the market value of the securities for each loan at least equals the amount of the loan at the time it is made.

fn12 If the wheels and axles of the manufactured home have been removed and it is permanently affixed to a foundation, a loan secured by a combination of a manufactured home and developed residential lot on which it sits may be treated as a home loan.

fn13 Without regard to any limitations of this part, a Federal savings association may make or invest in the fully insured or guaranteed portion of nonresidential real estate loans insured or guaranteed by the Economic Development Administration, the Farmers Home Administration, or the Small Business Administration. Unguaranteed portions of guaranteed loans must be aggregated with uninsured loans when determining an association's compliance with the 400% of capital limitation for other real estate loans.

fn14 This category includes obligations issued by any state, territory, or possession of the United States or political subdivision thereof (including any agency, corporation, or instrumentality of a state or political subdivision), subject to § 560.42 of this part.

fn15 A Federal savings association may invest in state housing corporations subject to the provisions of § 560.121 of this part.

fn16 Payments on accounts in excess of the account balance (overdrafts) on commercial deposit or transaction accounts shall be considered commercial loans for purposes of determining the association's percentage of assets limitation.

§ 560.31 -- Election regarding categorization of loans or investments and related calculations.

(a) If a loan or other investment is authorized under more than one section of the HOLA, as amended, or this part, a Federal savings association may designate under which section the loan or investment has been made. Such a loan or investment may be apportioned among appropriate categories, and may be moved, in whole or part, from one category to another. A loan commitment shall be counted as an investment and included in total assets of a Federal savings association for purposes of calculating compliance with HOLA section 5(c)'s investment limitations only to the extent that funds have been advanced and not repaid pursuant to the commitment.

(b) Loans or portions of loans sold to a third party shall be included in the calculation of a percentage-of-assets or percentage-of-capital investment limitation only to the extent they are sold with recourse.

(c) A Federal savings association may make a loan secured by an assignment of loans to the extent that it could, under applicable law and regulations, make or purchase the underlying assigned loans.

§ 560.33 -- Late charges.

A Federal savings association may include in a home loan contract a provision authorizing the imposition of a late charge with respect to the payment of any delinquent periodic payment. With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, no late charge, regardless of form, shall be assessed or collected by a Federal savings association, unless any billing, coupon, or notice the Federal savings association may provide regarding installment payments due on the loan discloses the date after which the charge may be assessed. A Federal savings association may not impose a late charge more than one time for late payment of the same installment, and any installment payment made by the borrower shall be applied to the longest outstanding installment due. A Federal savings association shall not assess a late charge as to any payment received by it within fifteen days after the due date of such payment. No form of such late charge permitted by this paragraph shall be considered as interest to the Federal savings association and the Federal savings association shall not deduct late charges from the regular periodic installment payments on the loan, but must collect them as such from the borrower.

§ 560.34 -- Prepayments.

Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless the loan contract or the borrower specifies otherwise. Subject to the terms of the loan contract, a Federal savings association may impose a fee for any prepayment of a loan.

§ 560.35 -- Adjustments to home loans.

(a) For any home loan secured by borrower-occupied property, or property to be occupied by the borrower, adjustments to the interest rate, payment, balance, or term to maturity must comply with the limitations of this section and the disclosure and notice requirements of § 560.210 of this part.

(b) Adjustments to the interest rate shall correspond directly to the movement of an index satisfying the requirements of paragraph (d) of this section. A Federal savings association also may increase the interest rate pursuant to a formula or schedule that specifies the amount of the increase, the time at which it may be made, and which is set forth in the loan contract. A Federal savings association may decrease the interest rate at any time.

(c) Adjustments to the payment and the loan balance that do not reflect an interest-rate adjustment may be made if:

(1) The adjustments reflect a change in an index that may be used pursuant to paragraph (d) of this section;

(2) In the case of a payment adjustment, the adjustment reflects a change in the loan balance or is made pursuant to a formula, or to a schedule specifying the percentage or dollar change in the payment as set forth in the loan contract; or

(3) In the case of an open-end line-of-credit loan, the adjustment reflects an advance taken by the borrower under the line-of-credit and is permitted by the loan contract.

(d)(1) Any index used must be readily available and independently verifiable. If set forth in the loan contract, an association may use any combination of indices, a moving average of index values, or more than one index during the term of a loan.

(2) Except as provided in paragraph (d)(3) of this section, any index used must be a national or regional index.

(3) A Federal savings association may use an index not satisfying the requirements of paragraph (d)(2) of this section 30 days after filing a notice in accordance with § 516.1(c) of this chapter unless, within that 30-day period, OTS has notified the association that the notice presents supervisory concerns or raises significant issues of law or policy. If OTS does notify the association of such concerns or issues, the Federal savings association may not use such an index unless and until it applies for and receives OTS's prior written approval in accordance with § 516.1(c) of this chapter.

§ 560.40 -- Commercial paper and corporate debt securities.

Pursuant to HOLA section 5(c)(2)(D), a Federal savings association may invest in, sell, or hold commercial paper and corporate debt securities subject to the provisions of this section.

(a) *Limitations.* (1) Commercial paper must be:

(i) As of the date of purchase, rated in either one of the two highest categories by at least two nationally recognized investment ratings services as shown by the most recently published rating made of such investments; or

(ii) If unrated, guaranteed by a company having outstanding paper that is rated as provided in paragraph (a)(1)(i) of this section.

(2) Corporate debt securities must be:

(i) Securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value; and

(ii) Rated in one of the four highest categories by a nationally recognized investment ratings service at its most recently published rating before the date of purchase of the security.

(3) A Federal savings association's total investment in the commercial paper and corporate debt securities of any one issuer, or issued by any one **[*50975]** person or entity affiliated with such issuer, together with other loans, shall not exceed the general lending limitations contained in § 560.93(c) of this part.

(4) Investments in corporate debt securities convertible into stock are subject to the following additional limitations:

(i) The purchase of securities convertible into stock at the option of the issuer is prohibited;

(ii) At the time of purchase, the cost of such securities must be written down to an amount that represents the investment value of the securities considered independently of the conversion feature; and

(iii) Federal savings associations are prohibited from exercising the conversion feature.

(5) A Federal savings association shall maintain information in its files adequate to demonstrate that it has exercised prudent judgment in making investments under this section.

(b) Notwithstanding the limitations contained in this section, the Office may permit investment in corporate debt securities of another savings association in connection with the purchase or sale of a branch office or in connection with a supervisory merger or acquisition.

§ 560.41 -- Leasing.

(a) *Permissible activities.* Subject to the limitations of this section, a Federal savings association may engage in leasing activities. These activities include becoming the legal or beneficial owner of tangible personal property or real property for the purpose of leasing such property, obtaining an assignment of a lessor's interest in a lease of such property, and incurring obligations incidental to its position as the legal or beneficial owner and lessor of the leased property.

(b) *Definitions.* For the purposes of this section:

(1) The term *net lease* means a lease under which the Federal savings association will not, directly or indirectly, provide or be obligated to provide for:

(i) The servicing, repair or maintenance of the leased property during the lease term;

(ii) The purchasing of parts and accessories for the leased property, except that improvements and additions to the leased property may be leased to the lessee upon its request in accordance with the full-payout requirements of paragraph (c)(2)(i) of this section;

(iii) The loan of replacement or substitute property while the leased property is being serviced;

(iv) The purchasing of insurance for the lessee, except where the lessee has failed to discharge a contractual obligation to purchase or maintain insurance; or

(v) The renewal of any license, registration, or filing for the property unless such action by the Federal savings association is necessary to protect its interest as an owner or financier of the property.

(2) The term *full-payout lease* means a lease transaction in which any unguaranteed portion of the estimated residual value relied on by the association to yield the return of its full investment in the leased property, plus the estimated cost of financing the property over the term of the lease, does not exceed 25% of the original cost of the property to the lessor. In general, a lease will qualify as a full-payout lease if the scheduled payments provide at least 75% of the principal and interest payments that a lessor would receive if the finance lease were structured as a market-rate loan.

(3) The term *realization of investment* means that a Federal savings association that enters into a lease financing transaction must reasonably expect to realize the return of its full investment in the leased property, plus the estimated cost of financing the property over the term of the lease from:

(i) Rentals;

(ii) Estimated tax benefits, if any; and

(iii) The estimated residual value of the property at the expiration of the term of the lease.

(c) *Finance leasing* -(1) *Investment limits.* A Federal savings association may exercise its authority under HOLA sections 5(c)(1)(B) (residential real estate loans), 5(c)(2)(A) (commercial, business, corporate or agricultural loans), 5(c)(2)(B) (nonresidential real estate loans), and 5(c)(2)(D) (consumer loans) by conducting leasing activities that are the functional equivalent of loans made under those HOLA sections. These activities are commonly referred to as financing leases. Such financing leases are subject to the same investment limits that apply to loans made under those sections. For example, a financing lease of tangible personal property made to a natural person for personal, family or household purposes is subject to all limitations applicable to the amount of a Federal savings association's investment in consumer loans. A financing lease made for commercial, corporate, business, or agricultural purposes is subject to all limitations applicable to the amount of a Federal savings association's investment in commercial loans. A financing lease of residential or nonresidential real property is subject to all limitations applicable to the amount of a Federal savings association's investment in these types of real estate loans.

(2) *Functional equivalent of lending.* To qualify as the functional equivalent of a loan:

(i) The lease must be a net, full-payout lease representing a non-cancelable obligation of the lessee, notwithstanding the possible early termination of the lease;

(ii) The portion of the estimated residual value of the property relied upon by the lessor to satisfy the requirements of a full-payout lease must be reasonable in light of the nature of the leased property and all relevant circumstances so that realization of the lessor's full investment plus the cost of financing the property depends primarily on the creditworthiness of the lessee, and not on the residual market value of the leased property; and

(iii) At the termination of a financing lease, either by expiration or default, property acquired must be liquidated or released on a net basis as soon as practicable. Any property held in anticipation of re-leasing must be reevaluated and recorded at the lower of fair market value or book value.

(d) *General leasing.* Pursuant to section 5(c)(2)(C) of the HOLA, a Federal savings association may invest in tangible personal property, including vehicles, manufactured homes, machinery, equipment, or furniture, for the purpose of leasing that property. In contrast to financing leases, lease investments made under this authority need not be the functional equivalent of loans.

(e) *Leasing salvage powers.* If, in good faith, a Federal savings association believes that there has been an unanticipated change in conditions that threatens its financial position by significantly increasing its exposure to loss, it may:

(1) As the owner and lessor, take reasonable and appropriate action to salvage or protect the value of the property or its interest arising under the lease;

(2) As the assignee of a lessor's interest in a lease, become the owner and lessor of the leased property pursuant to its contractual right, or take any reasonable and appropriate action to salvage or protect the value of the property or its interest arising under the lease; or

(3) Include any provisions in a lease, or make any additional agreements, to protect its financial position or investment in the circumstances set forth in paragraphs (e)(1) and (e)(2) of this section. **[*50976]**

§ 560.42 -- State and local government obligations.

Pursuant to HOLA section 5(c)(1)(H), a Federal savings association may invest in obligations issued by any state, territory, possession, or political subdivision thereof, subject to the following conditions:

(a) A Federal savings association may not invest more than 10% of its total capital in obligations of any one issuer, exclusive of general obligations of the issuer.

(b) Except as provided in paragraph (c) of this section, the obligations must:

(1) Continue to hold one of the four highest national investment grade ratings; or

(2) Must be issued by a public housing agency and backed by the full faith and credit of the United States.

(c) Notwithstanding the limitations in paragraph (b) of this section, a Federal savings association may invest:

(1) In the aggregate, up to one percent of its assets in the obligations of a state, territory, possession, or political subdivision in which the association's home office or a branch office is located; or

(2) In any obligations approved by the Office.

§ 560.43 -- Foreign assistance investments.

Pursuant to HOLA section 5(c)(4)(C), a Federal savings association may make foreign assistance investments in an aggregate amount not to exceed one percent of its assets, subject to the following conditions:

(a) For any investment made under the Foreign Assistance Act, the loan agreement shall specify what constitutes an event of default, and provide that upon default in payment of principal or interest under such agreement, the entire amount of outstanding indebtedness thereunder shall become immediately due and payable, at the lender's option. Additionally, the contract of guarantee shall cover 100% of any loss of investment thereunder, except for any portion of the loan arising out of fraud or misrepresentation for which the party seeking payment is responsible, and provide that the guarantor shall pay for any such loss in U.S. dollars within a specified reasonable time after the date of application for payment.

(b) To make any investments in the share capital and capital reserve of the Inter-American Savings and Loan Bank, a Federal savings association must be adequately capitalized and have adequate allowances for loan and lease losses. The Federal savings association's aggregate investment in such capital or capital reserve, including the amount of any obligations undertaken to provide said Bank with reserve capital in the future (call-able capital), must not, as a result of such investment, exceed the lesser of one-quarter of 1% of its assets or $ 100,000.

Subpart B--Lending and Investment Provisions Applicable to all Savings Associations

§ 560.93 -- Lending limitations.

(a) *Scope.* This section applies to all loans and extensions of credit made by a savings association and its subsidiaries. This section does not apply to loans made by a savings association to its subsidiaries or to its affiliates. The terms *subsidiary* and *affiliate* have the same meanings as those terms are defined in § 563.41 of this chapter.

(b) *Definitions.* In applying these lending limitations, savings associations shall apply the definitions and interpretations promulgated by the Office of the Comptroller of the Currency consistent with *12 U.S.C. 84.* See 12 CFR part 32.

In applying these definitions, pursuant to *12 U.S.C. 1464,* savings associations shall use the terms *savings association, savings associations,* and *savings association's* in place of the terms *national bank* and *bank, banks, and bank's,* respectively. For purposes of this section:

(1) The term *one borrower* has the same meaning as the term *person* set forth at 12 CFR part 32. It also includes, in addition to the definition cited therein, a *financial institution* as defined at § 561.19 of this chapter.

(2) The term *company* means a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term *company* includes a *savings association* and a *bank.*

(3) *Contractual commitment to advance funds* has the meaning set forth in 12 CFR part 32.

(4) *Loans and extensions of credit* has the meaning set forth in 12 CFR part 32, and includes investments in commercial paper and corporate debt securities. The Office expressly reserves its authority to deem other arrangements that are, in substance, *loans and extensions of credit* to be encompassed by this term.

(5) The term *loans* as used in the phrase *Loans to one borrower to finance the sale of real property acquired in satisfaction of debts previously contracted for in good faith* does not include an association's taking of a purchase money mortgage note from the purchaser *provided that:*

(i) No new funds are advanced by the association to the borrower; and

(ii) The association is not placed in a more detrimental position as a result of the sale.

(6) The term *fully phased-in capital standards* means the capital standards that will be in effect at the expiration of all statutory and regulatory phase-in requirements set forth in *12 U.S.C. 1464*(t) and §§ 567.2, 567.5, and 567.9 of this chapter.

(7) *Readily marketable collateral* has the meaning set forth in 12 CFR part 32.

(8) *Residential housing units* has the same meaning as the term *residential real estate* set forth in § 541.23 of this chapter. The term *to develop* includes the various phases necessary to produce housing units as an end product, to include: acquisition, development and construction; development and construction; construction; rehabilitation; or conversion. The term *domestic* includes units within the fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, and the Pacific Islands.

(9) *Single family dwelling unit* has the meaning set forth in § 541.20 of this chapter.

(10) A *standby letter of credit* has the meaning set forth in 12 CFR part 32.

(11) *Unimpaired capital and unimpaired surplus* means-

(i) A savings association's core capital and supplementary capital included in its total capital under part 567 of this chapter; plus

(ii) The balance of a savings association's allowance for loan and lease losses not included in supplementary capital under part 567 of this chapter; plus

(iii) The amount of a savings association's loans to, investments in, and advances to subsidiaries not included in calculating core capital under part 567 of this chapter.

(c) *General limitation.* Section 5200 of the Revised Statutes *(12 U.S.C. 84)* shall apply to savings associations in the same manner and to the same extent as it applies to national banks. This statutory provision and lending limit regulations and interpretations promulgated by the Office of the Comptroller of the Currency pursuant to a rulemaking conducted in accordance with the provisions of the Administrative Procedure Act, *5 U.S.C. 553* et seq. (including the regulations appearing at 12 CFR part 32) shall apply to savings associations in the same manner and to the same extent as these provisions apply to national banks:

(1) The total loans and extensions of credit by a savings association to one borrower outstanding at one time and not fully secured, as determined in the same manner as determined under *12* **[*50977]** *U.S.C. 84*(a)(2), by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 percent of the unimpaired capital and unimpaired surplus of the association.

(2) The total loans and extensions of credit by a savings association to one borrower outstanding at one time and fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the funds outstanding shall not exceed 10 per centum of the unimpaired capital and unimpaired surplus of the association. This limitation shall be separate from and in addition to the limitation contained in paragraph (c)(1) of this section.

(d) *Exceptions to the general limitation* -(1) *$ 500,000 exception.* If a savings association's aggregate lending limitation calculated under paragraphs (c)(1) and (c)(2) of this section is less than $ 500,000, notwithstanding this aggregate limitation in paragraphs (c)(1) and (c)(2) of this section, such savings association may have total loans and extensions of credit, for any purpose, to one borrower outstanding at one time not to exceed $ 500,000.

(2) *Statutory exceptions.* The exceptions to the lending limits set forth in *12 U.S.C. 84* and 12 CFR part 32 are applicable to savings associations in the same manner and to the extent as they apply to national banks.

(3) *Loans to develop domestic residential housing units.* Subject to paragraph (d)(4) of this section, a savings association may make loans to one borrower to develop domestic residential housing units, not to exceed the lesser of $ 30,000,000 or 30 percent of the savings association's unimpaired capital and unimpaired surplus, including all amounts loaned under the authority of the General Limitation set forth under paragraphs (c)(1) and (c)(2) of this section, *provided that:*

(i) The final purchase price of each single family dwelling unit the development of which is financed under this paragraph (d)(3) does not exceed $ 500,000;

(ii) The savings association is, and continues to be, in compliance with its fully phased-in capital standards, as defined in paragraph (b)(6) of this section;

(iii) OTS permits, subject to conditions it may impose, the savings association to use the higher limit set forth under this paragraph (d)(3). A savings association that meets the requirements of paragraphs (d)(3) (i), (ii), (iv) and (v) of this section and that meets the requirements for "expedited treatment" under § 516.3(a) of this chapter may use the higher limit set forth under this paragraph (d)(3) if the savings association has filed a notice with OTS that it intends to use the higher limit at least 30 days prior to the proposed use. A savings association that meets the requirements of paragraphs (d)(3) (i), (ii), (iv) and (v) of this section and that meets the requirements for "standard treatment" under § 516.3(b) of this chapter may use the higher limit set forth under this paragraph (d)(3) if the savings association has filed a notice with OTS and an order has been issued permitting the savings association to use the higher limit;

(iv) Loans made under this paragraph (d)(3) to all borrowers do not, in aggregate, exceed 150 percent of the savings association's unimpaired capital and unimpaired surplus; and

(v) Such loans comply with the applicable loan-to-value requirements that apply to Federal savings associations.

(4) The authority of a savings association to make a loan or extension of credit under the exception in paragraph (d)(3) of this section ceases immediately upon the association's failure to comply with any one of the requirements set forth in paragraph (d)(3) of this section or any condition(s) set forth in a Director's order under paragraph (d)(3)(iii) of this section.

(5) Notwithstanding the limit set forth in paragraphs (c)(1) and (c)(2) of this section, a savings association may invest up to 10 percent of unimpaired capital and unimpaired surplus in the obligations of one issuer evidenced by:

(i) Commercial paper rated, as of the date of purchase, as shown by the most recently published rating by at least two nationally recognized investment rating services in the highest category; or

(ii) Corporate debt securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value, and that are rated in one of the two highest categories by a nationally recognized investment rating service in its most recently published ratings before the date of purchase of the security.

(e) *Loans to finance the sale of REO.* A savings association's loans to one borrower to finance the sale of real property acquired in satisfaction of debts previously contracted for in good faith shall not, when aggregated with all other loans to such borrower, exceed the General Limitation in paragraph (c)(1) of this section.

(f) *Calculating compliance and recordkeeping.* (1) The amount of an association's unimpaired capital and unimpaired surplus pursuant to paragraph (b)(11) of this section shall be calculated as of the association's most recent periodic report required to be filed with OTS prior to the date of granting or purchasing the loan or otherwise creating the obligation to repay funds, unless the association knows, or has reason to know, based on transactions or events actually completed, that such level has changed significantly, upward or downward, subsequent to filing of such report.

(2) If a savings association or subsidiary thereof makes a loan or extension of credit to any one borrower, as defined in paragraph (b)(1) of this section, in an amount that, when added to the total balances of all outstanding loans owed to such association and its subsidiary by such borrower, exceeds the greater of $ 500,000 or 5 percent of unimpaired capital and unimpaired surplus, the records of such association or its subsidiary with respect to such loan shall include documentation showing that such loan was made within the limitations of paragraphs (c) and (d) of this section; for the purpose of such documentation such association or subsidiary may require, and may accept in good faith, a certification by the borrower identifying the persons, entities, and interests described in the definition of one borrower in paragraph (b)(1) of this section.

(g) [Reserved]

(h) *More stringent restrictions.* The Director may impose more stringent restrictions on a savings association's loans to one borrower if the Director determines that such restrictions are necessary to protect the safety and soundness of the savings association.

Appendix to § 560.93--Interpretations

Section 560.93-100 Interrelation of General Limitation With Exception for Loans To Develop Domestic Residential Housing Units

1. The § 560.93(d)(3) exception for loans to one person to develop domestic residential housing units is characterized in the regulation as an "alternative" limit. This exceptional $ 30,000,000 or 30 percent limitation does not operate *in addition to* the 15 percent General Limitation or the 10 percent additional amount an association may loan to one borrower secured by readily marketable collateral, but serves as the uppermost limitation on a savings association's lending to any one person once an association employs this exception. An example will illustrate the Office's interpretation of the application of this rule:

Example: Savings Associations A's lending limitation as calculated under the 15 percent General Limitation is $ 800,000. If Association A lends Y $ 800,000 for commercial purposes, Association A cannot lend Y *an additional* $ 1,600,000, or 30 percent of capital and surplus, to develop **[*50978]** residential housing units under the paragraph (d)(3) exception. The (d)(3) exception operates as the uppermost limitation on all lending to one borrower (for associations that may employ this exception) *and includes any amounts loaned to the same borrower under the General Limitation.* Association A, therefore, may lend only an additional $ 800,000 to Y, provided the paragraph (d)(3) prerequisites have been met. The amount loaned under the authority of the General Limitation ($ 800,000), when added to the amount loaned under the exception ($ 800,000), yields a sum that does not exceed the 30 percent uppermost limitation ($ 1,600,000).

2. This result does not change even if the facts are altered to assume that some or all of the $ 800,000 amount of lending permissible under the General Limitation's 15 percent basket is not used, or is devoted to the development of domestic residential housing units.

In other words, using the above example, if Association A lends Y $ 400,000 for commercial purposes and $ 300,000 for residential purposes-both of which would be permitted under the Association's $ 800,000 General Limitation-Association A's remaining permissible lending to Y would be: first, an additional $ 100,000 under the General Limitation, and then another $ 800,000 to develop domestic residential housing units if the Association meets the paragraph (d)(3) prerequisites. (The latter is $ 800,000 because in no event may the total lending to Y exceed 30 percent of unimpaired capital and unimpaired surplus). If Association A did not lend Y the remaining $ 100,000 permissible under the General Limitation, its permissible loans to develop domestic residential housing units under paragraph (d)(3) would be $ 900,000 instead of $ 800,000 (the total loans to Y would still equal $ 1,600,000).

3. In short, under the paragraph (d)(3) exception, the 30 percent or $ 30,000,000 limit will always operate as the uppermost limitation, unless of course the association does not avail itself of the exception and merely relies upon its General Limitation.

Section 560.93-101 Interrelationship Between the General Limitation and the 150 Percent Aggregate Limit on Loans to all Borrowers To Develop Domestic Residential Housing Units

1. The Office has already received numerous questions regarding the allocation of loans between the different lending limit "baskets," *i.e.*, the 15 percent General Limitation basket and the 30 percent Residential Development basket. In general, the inquiries concern the manner in which an association may "move" a loan from the General Limitation basket to the Residential Development basket. The following example is intended to provide guidance:

Example: Association A's General Limitation under section 5(u)(1) is $ 15 million. In January, Association A makes a $ 10 million loan to Borrower to develop domestic residential housing units. At the time the loan was made, Association A had not received approval under a Director order to avail itself of the residential development exception to lending limits. Therefore, the $ 10 million loan is made under Association A's General Limitation.

2. In June, Association A receives authorization to lend under the Residential Development exception. In July, Association A lends $ 3 million to Borrower to develop domestic residential housing units. In August, Borrower seeks an additional $ 12 million commercial loan from Association A. Association A cannot make the loan to Borrower, however, because it already has an outstanding $ 10 million loan to Borrower that counts against Association A's General Limitation of $ 15 million. Thus, Association A may lend only up to an additional $ 5 million to Borrower under the General Limitation.

3. However, Association A may be able to reallocate the $ 10 million loan it made to Borrower in January to its Residential Development basket provided that: (1) Association A has obtained authority under a Director's order to avail itself of the additional lending authority for residential development and maintains compliance with all prerequisites to such lending authority; (2) the original $ 10 million loan made in January constitutes a loan to develop domestic residential housing units as defined; and (3) the housing unit(s) constructed with the funds from the January loan remain in a stage of "development" at the time Association A reallocates the loan to the domestic residential housing basket. The project must be in a stage of acquisition, development, construction, rehabilitation, or conversion in order for the loan to be reallocated.

4. If Association A is able to reallocate the $ 10 million loan made to Borrower in January to its Residential Development basket, it may make the $ 12 million commercial loan requested by Borrower in August. Once the January loan is reallocated to the Residential Development basket, however, the $ 10 million loan counts towards Association's 150 percent aggregate limitation on loans to all borrowers under the residential development basket (section 5(u)(2)(A)(ii)(IV)).

5. If Association A reallocates the January loan to its domestic residential housing basket and makes an additional $ 12 million commercial loan to Borrower, Association A's totals under the respective limitations would be: $ 12 million under the General Limitation; and $ 13 million under the Residential Development limitation. The full $ 13 million residential development loan counts toward Association A's aggregate 150 percent limitation.

§ 560.100 -- Real estate lending standards; purpose and scope.

This section, and § 560.101 of this subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, *12 U.S.C. 1828*(o), prescribe standards for real estate lending to be used by savings associations and all their includable subsidiaries, as defined in *12 CFR 567.1(l)*, over which the savings associations exercise control, in adopting internal real estate lending policies.

§ 560.101 -- Real estate lending standards.

(a) Each savings association shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) (1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the savings association's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the savings association's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the savings association's real estate lending policies.

(c) Each savings association must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

Appendix to § 560.101--Interagency Guidelines for Real Estate Lending Policies

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements. n1 These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and **[*50979]** scope of its individual operations, as well as satisfies the requirements of the regulation.

n1 The agencies have adopted a uniform rule on real estate lending. See 12 CFR Part 365 (FDIC); 12 CFR Part 208, Subpart C (FRB); 12 CFR Part 34, Subpart D (OCC); and *12 CFR 560.100-560.101 (OTS)*.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

Loan Portfolio Management Considerations

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

. Identify the geographic areas in which the institution will consider lending.

. Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).

. Identify appropriate terms and conditions by type of real estate loan.

. Establish loan origination and approval procedures, both generally and by size and type of loan.

. Establish prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.

. Establish review and approval procedures for exception loans, including loans with loan-to-value percentages in excess of supervisory limits.

. Establish loan administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review.

. Establish real estate appraisal and evaluation programs.

. Require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.

The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include:

. The size and financial condition of the institution.

. The expertise and size of the lending staff.

. The need to avoid undue concentrations of risk.

. Compliance with all real estate related laws and regulations, including the Community Reinvestment Act, anti-discrimination laws, and for savings associations, the Qualified Thrift Lender test.

. Market conditions.

The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:

. Demographic indicators, including population and employment trends.

. Zoning requirements.

. Current and projected vacancy, construction, and absorption rates.

. Current and projected lease terms, rental rates, and sales prices, including concessions.

. Current and projected operating expenses for different types of projects.

. Economic indicators, including trends and diversification of the lending area.

. Valuation trends, including discount and direct capitalization rates.

Underwriting Standards

Prudently underwritten real estate loans should reflect all relevant credit factors, including:

. The capacity of the borrower, or income from the underlying property, to adequately service the debt.

. The value of the mortgaged property.

. The overall creditworthiness of the borrower.

. The level of equity invested in the property.

. Any secondary sources of repayment.

. Any additional collateral or credit enhancements (such as guarantees, mortgage insurance or takeout commitments).

The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address:

. The maximum loan amount by type of property.

. Maximum loan maturities by type of property.

. Amortization schedules.

. Pricing structure for different types of real estate loans.

. Loan-to-value limits by type of property.

For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property:

. Requirements for feasibility studies and sensitivity and risk analyses (*e.g.*, sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses).

. Minimum requirements for initial investment and maintenance of hard equity by the borrower (*e.g.*, cash or unencumbered investment in the underlying property).

. Minimum standards for net worth, cash flow, and debt service coverage of the borrower or underlying property.

. Standards for the acceptability of and limits on non-amortizing loans.

. Standards for the acceptability of and limits on the use of interest reserves.

. Pre-leasing and pre-sale requirements for income-producing property.

. Pre-sale and minimum unit release requirements for non-income-producing property loans.

. Limits on partial recourse or nonrecourse loans and requirements for guarantor support.

. Requirements for takeout commitments.

. Minimum covenants for loan agreements.

Loan Administration

The institution should also establish loan administration procedures for its real estate portfolio that address:

. Documentation, including:

Type and frequency of financial statements, including requirements for verification of information provided by the borrower;

Type and frequency of collateral evaluations (appraisals and other estimates of value).

. Loan closing and disbursement.

. Payment processing.

. Escrow administration.

. Collateral administration.

. Loan payoffs.

. Collections and foreclosure, including:

Delinquency follow-up procedures;

Foreclosure timing;

Extensions and other forms of forbearance;

Acceptance of deeds in lieu of foreclosure.

. Claims processing (*e.g.*, seeking recovery on a defaulted loan covered by a government guaranty or insurance program).

. Servicing and participation agreements.

Supervisory Loan-to-Value Limits

Institutions should establish their own internal loan-to-value limits for real estate loans. These internal limits should not exceed the following supervisory limits:

Loan category	Loan-to-value limit (percent)
Raw land	65
Land development	75
Construction:	
Commercial, multifamily, fn1 and other nonresidential	80
1- to 4-family residential	85
Improved property	85
Owner-occupied 1- to 4-family and home equity	(fn2)

fn1 Multifamily construction includes condominiums and cooperatives.

fn2 A loan-to-value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1- to 4-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

The supervisory loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each **[*50980]** property. To ensure that collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.

In establishing internal loan-to-value limits, each lender is expected to carefully consider the institution-specific and market factors listed under "Loan Portfolio Management Considerations," as well as any other relevant factors, such as the particular subcategory or type of loan. For any subcategory of loans that exhibits greater credit risk than the overall category, a lender should consider the establishment of an internal loan-to-value limit for that subcategory that is lower than the limit for the overall category.

The loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan. Other credit factors to be taken into account are highlighted in the "Underwriting Standards" section above. Because of these other factors, the establishment of these supervisory limits should not be interpreted to mean that loans at these levels will automatically be considered sound.

Loans in Excess of the Supervisory Loan-to-Value Limits

The agencies recognize that appropriate loan-to-value limits vary not only among categories of real estate loans but also among individual loans. Therefore, it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits, based on the support provided by other credit factors. Such loans should be identified in the institutions' records, and their aggregate amount reported at least quarterly to the institution's board of directors. (See additional reporting requirements described under "Exceptions to the General Policy.") The aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital. n2 Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non-1-to- 4 family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

n2 For the state member banks, the term "total capital" means "total risk-based capital" as defined in Appendix A to 12 CFR Part 208. For insured state non-member banks, "total capital" refers to that term described in table I of Appendix A to 12 CFR Part 325. For national banks, the term "total capital" is defined at *12 CFR 3.2(e)*. For savings associations, the term "total capital" is defined at *12 CFR 567.5(c)*.

In determining the aggregate amount of such loans, institutions should: (a) Include all loans secured by the same property if any one of those loans exceeds the supervisory loan-to-value limits; and (b) include the recourse obligation of any such loan sold with recourse. Conversely, a loan should no longer be reported to the directors as part of aggregate totals when reduction in principal or senior liens, or additional contribution of collateral or equity (e.g., improvements to the real property securing the loan), bring the loan-to-value ratio into compliance with supervisory limits.

Excluded Transactions

The agencies also recognize that there are a number of lending situations in which other factors significantly outweigh the need to apply the supervisory loan-to-value limits.

These include:

. Loans guaranteed or insured by the U.S. government or its agencies, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.

. Loans backed by the full faith and credit of a state government, provided that the amount of the assurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.

. Loans guaranteed or insured by a state, municipal or local government, or an agency thereof, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit, and provided that the lender has determined that the guarantor or insurer has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement.

. Loans that are to be sold promptly after origination, without recourse, to a financially responsible third party.

. Loans that are renewed, refinanced, or restructured without the advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or loans that are renewed, refinanced, or restructured in connection with a workout situation, either with or without the advancement of new funds, where consistent with safe and sound banking practices and part of a clearly defined and well-documented program to achieve orderly liquidation of the debt, reduce risk of loss, or maximize recovery on the loan.

. Loans that facilitate the sale of real estate acquired by the lender in the ordinary course of collecting a debt previously contracted in good faith.

. Loans for which a lien on or interest in real property is taken as additional collateral through an abundance of caution by the lender (e.g., the institution takes a blanket lien on all or substantially all of the assets of the borrower, and the value of the real property is low relative to the aggregate value of all other collateral).

. Loans, such as working capital loans, where the lender does not rely principally on real estate as security and the extension of credit is not used to acquire, develop, or construct permanent improvements on real property.

. Loans for the purpose of financing permanent improvements to real property, but not secured by the property, if such security interest is not required by prudent underwriting practice.

Exceptions to the General Lending Policy

Some provision should be made for the consideration of loan requests from creditworthy borrowers whose credit needs do not fit within the institution's general lending policy. An institution may provide for prudently underwritten exceptions to its lending policies, including loan-to-value limits, on a loan-by-loan basis. However, any exceptions from the supervisory loan-to-value limits should conform to the aggregate limits on such loans discussed above.

The board of directors is responsible for establishing standards for the review and approval of exception loans. Each institution should establish an appropriate internal process for the review and approval of loans that do not conform to its own internal policy standards. The approval of any such loan should be supported by a written justification that clearly sets forth all of the relevant credit factors that support the underwriting decision. The justification and approval documents for such loans should be maintained as a part of the permanent loan file. Each institution should monitor compliance with its real estate lending policy and individually report exception loans of a significant size to its board of directors.

Supervisory Review of Real Estate Lending Policies and Practices

The real estate lending policies of institutions will be evaluated by examiners during the course of their examinations to determine if the policies are consistent with safe and sound lending practices, these guidelines, and the requirements of the regulation. In evaluating the adequacy of the institution's real estate lending policies and practices, examiners will take into consideration the following factors:

. The nature and scope of the institution's real estate lending activities.

. The size and financial condition of the institution.

. The quality of the institution's management and internal controls.

. The expertise and size of the lending and loan administration staff.

. Market conditions.

Lending policy exception reports will also be reviewed by examiners during the course of their examinations to determine whether the institutions' exceptions are adequately documented and appropriate in light of all of the relevant credit considerations. An excessive volume of exceptions to an institution's real estate lending policy may signal a weakening of its underwriting practices, or may suggest a need to revise the loan policy.

Definitions

For the purposes of these Guidelines:

Construction loan means an extension of credit for the purpose of erecting or rehabilitating buildings or other structures, including any infrastructure necessary for development.

Extension of credit or loan means:

(1) The total amount of any loan, line of credit, or other legally binding lending commitment with respect to real property; and

(2) The total amount, based on the amount of consideration paid, of any loan, line of credit, or other legally binding lending commitment acquired by a lender by purchase, assignment, or otherwise. **[*50981]**

Improved property loan means an extension of credit secured by one of the following types of real property:

(1) Farmland, ranchland or timberland committed to ongoing management and agricultural production;

(2) 1- to 4-family residential property that is not owner-occupied;

(3) Residential property containing five or more individual dwelling units;

(4) Completed commercial property; or

(5) Other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied 1- to 4-family residential property.

Land development loan means an extension of credit for the purpose of improving unimproved real property prior to the erection of structures. The improvement of unimproved real property may include the laying or placement of sewers, water pipes, utility cables, streets, and other infrastructure necessary for future development.

Loan origination means the time of inception of the obligation to extend credit (i.e., when the last event or prerequisite, controllable by the lender, occurs causing the lender to become legally bound to fund an extension of credit).

Loan-to-value or *loan-to-value ratio* means the percentage or ratio that is derived at the time of loan origination by dividing an extension of credit by the total value of the property(ies) securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral that secures the extension of credit. The total amount of all senior liens on or interests in such property(ies) should be included in determining the loan-to-value ratio. When mortgage insurance or collateral is used in the calculation of the loan-to-value ratio, and such credit enhancement is later released or replaced, the loan-to-value ratio should be recalculated.

Other acceptable collateral means any collateral in which the lender has a perfected security interest, that has a quantifiable value, and is accepted by the lender in accordance with safe and sound lending practices. Other acceptable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral. Other acceptable collateral includes, among other items, unconditional irrevocable standby letters of credit for the benefit of the lender.

Owner-occupied, when used in conjunction with the term *1- to 4-family residential property* means that the owner of the underlying real property occupies at least one unit of the real property as a principal residence of the owner.

Readily marketable collateral means insured deposits, financial instruments, and bullion in which the lender has a perfected interest. Financial instruments and bullion must be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, on an auction or similarly available daily bid and ask price market. Readily marketable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral.

Value means an opinion or estimate, set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agency's appraisal regulations and guidance. For loans to purchase an existing property, the term "value" means the lesser of the actual acquisition cost or the estimate of value.

1- to 4-family residential property means property containing fewer than five individual dwelling units, including manufactured homes permanently affixed to the underlying property (when deemed to be real property under state law).

§ 560.110 -- Most favored lender usury preemption.

(a) *Definition.* The term "interest" as used in *12 U.S.C. 1463*(g) includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

(b) *Authority.* A savings association located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a federal savings association making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a federal savings association may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies. Except as provided in this paragraph, the applicability of state law to Federal savings associations shall be determined in accordance with § 560.2 of this part. State supervisors determine the degree to which state-chartered savings associations must comply with state laws other than those imposing restrictions on interest, as defined in paragraph (a) of this section.

(c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a savings association is located but state law permits its most favored lender to charge late fees, then a savings association located in that state may charge late fees to its intrastate customers. The savings association may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the savings association is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

§ 560.120 -- Letters of credit and other independent undertakings to pay against documents.

(a) *General authority.* To the extent that it has legal authority to do so, a savings association may issue and commit to issue letters of credit within the scope of applicable laws or rules of practice recognized by law. n1 It may also issue other independent undertakings within the scope of such laws or rules of practice recognized by law, that have been approved by OTS (approved undertaking). Under such letters of credit and approved undertakings, the savings association's obligation to honor depends upon the presentation of specified documents and not upon nondocumentary conditions or resolution of questions of fact or law at issue between the account party and the beneficiary. A savings association may also confirm or otherwise undertake to honor or purchase specified documents **[*50982]** upon their presentation under another person's independent undertaking within the scope of such laws or rules.

n1 Samples of laws or rules of practice applicable to letters of credit and other independent undertakings include, but are not limited to: the applicable version of Article 5 of the Uniform Commercial Code (UCC) (1962, as amended 1990) or revised Article 5 of the UCC (as amended 1995) (available from West Publishing Co., 1/800/340-9378); the Uniform Customs and Practice for Documentary Credits (International Chamber of Commerce (ICC) Publication No. 500) (available from ICC Publishing, Inc., 212/206-1150); the United Nations Commission on International Trade Law (UNCITRAL) Convention on Independent Guarantees and Standby Letters of Credit (adopted by UNCITRAL 1995) (available from UNCITRAL, 212/963-5353); and the Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits (ICC Publication No. 525) (available from ICC Publishing, Inc., 212/206-1150); as any of the foregoing may be amended from time to time.

(b) *Safety and soundness considerations.* -(1) *Terms.* As a matter of safe and sound banking practice, savings associations that issue letters of credit or approved undertakings should not be exposed to undue risk. At a minimum, savings associations should consider the following:

(i) The independent character of the letter of credit or approved undertaking should be apparent from its terms (such as terms that subject it to laws or rules providing for its independent character);

(ii) The letter of credit or approved undertaking should be limited in amount;

(iii) The letter of credit or approved undertaking should:

(A) Be limited in duration; or

(B) Permit the savings association to terminate the letter of credit or approved undertaking, either on a periodic basis (consistent with the savings association's ability to make any necessary credit assessments) or at will upon either notice or payment to the beneficiary; or

(C) Entitle the savings association to cash collateral from the account party on demand (with a right to accelerate the customer's obligations, as appropriate); and

(iv) The savings association either should be fully collateralized or have a post-honor right of reimbursement from its customer or from another issuer of a letter of credit or an independent undertaking. Alternatively, if the savings association's undertaking is to purchase documents of title, securities, or other valuable documents, it should obtain a first priority right to realize on the documents if the savings association is not otherwise to be reimbursed.

(2) *Additional considerations in special circumstances.* Certain letters of credit and approved undertakings require particular protections against credit, operational, and market risk:

(i) In the event that the undertaking is to honor by delivery of an item of value other than money, the savings association should ensure that market fluctuations that affect the value of the item will not cause the savings association to assume undue market risk;

(ii) In the event that an undertaking provides for renewal, the terms for renewal should be consistent with the savings association's ability to make any necessary credit assessments prior to renewal; and

(iii) In the event that a savings association issues an undertaking for its own account, the underlying transaction for which it is issued must be within the savings association's authority and comply with any safety and soundness requirements applicable to that transaction.

(3) *Operational expertise.* The savings association should possess operational expertise that is commensurate with the sophistication of its letter of credit or independent undertaking activities.

(4) *Documentation.* The savings association must accurately reflect its letters of credit or approved undertakings in its records, including any acceptance or deferred payment or other absolute obligation arising out of its contingent undertaking.

§ 560.121 -- Investment in state housing corporations.

(a) Any savings association to the extent it has legal authority to do so, may make investments in, commitments to invest in, loans to, or commitments to lend to any state housing corporation; provided, that such obligations or loans are secured directly, or indirectly through a fiduciary, by a first lien on improved real estate which is insured under the National Housing Act, as amended, and that in the event of default, the holder of such obligations or loans has the right directly, or indirectly through a fiduciary, to subject to the satisfaction of such obligations or loans the real estate described in the first lien, or the insurance proceeds.

(b) Any savings association that is adequately capitalized may, to the extent it has legal authority to do so, invest in obligations (including loans) of, or issued by, any state housing corporation incorporated in the state in which such savings association has its home or a branch office; provided (except with respect to loans), that:

(1) The obligations are rated in one of the four highest grades as shown by the most recently published rating made of such obligations by a nationally recognized rating service; or

(2) The obligations, if not rated, are approved by the Office. The aggregate outstanding direct investment in obligations under paragraph (b) of this section shall not exceed the amount of the savings association's total capital.

(c) Each state housing corporation in which a savings association invests under the authority of paragraph (b) of this section shall agree, before accepting any such investment (including any loan or loan commitment), to make available at any time to the Office such information as the Office may consider to be necessary to ensure that investments are properly made under this section.

§ 560.160 -- Asset classification.

(a) (1) Each savings association shall evaluate and classify its assets on a regular basis in a manner consistent with, or reconcilable to, the asset classification system used by OTS in its Thrift Activities Handbook (Available at the address listed in § 516.1 of this chapter).

(2) In connection with the examination of a savings association or its affiliates, OTS examiners may identify problem assets and classify them, if appropriate. The association must recognize such examiner classifications in its subsequent reports to OTS.

(b) Based on the evaluation and classification of its assets, each savings association shall establish adequate valuation allowances or charge-offs, as appropriate, consistent with generally accepted accounting principles and the practices of the federal banking agencies.

§ 560.170 -- Records for lending transactions.

In establishing and maintaining its records pursuant to § 563.170 of this chapter, each savings association and service corporation should establish and maintain loan documentation practices that:

(a) Ensure that the institution can make an informed lending decision and can assess risk on an ongoing basis;

(b) Identify the purpose and all sources of repayment for each loan, and assess the ability of the borrower(s) and any guarantor(s) to repay the indebtedness in a timely manner;

(c) Ensure that any claims against a borrower, guarantor, security holders, and collateral are legally enforceable;

(d) Demonstrate appropriate administration and monitoring of its loans; and

(e) Take into account the size and complexity of its loans.

§ 560.172 -- Re-evaluation of real estate owned.

A savings association shall appraise each parcel of real estate owned at the earlier of in-substance foreclosure or at the time of the savings association's acquisition of such property, and at such times thereafter as dictated by prudent management policy; such appraisals shall be consistent with the requirements of part 564 of this chapter. The Regional Director or his or her designee may require subsequent appraisals if, in his or her discretion, such subsequent appraisal is necessary under the particular circumstances. The foregoing requirement shall not apply to any parcel of real estate that is sold and **[*50983]** reacquired less than 12 months subsequent to the most recent appraisal made pursuant to this part. A dated, signed copy of each report of appraisal made pursuant to any provisions of this part shall be retained in the savings association's records.

Subpart C--Alternative Mortgage Transactions

§ 560.210 -- Disclosures for adjustable-rate mortgage loans, adjustment notices, and interest-rate caps.

(a) *Definitions*. For purposes of this section:

(1) *Adjustable-rate mortgage loan* means a mortgage loan, secured by property occupied or to be occupied by the borrower, providing for adjustments to the interest rate which cause a change in balance, term to maturity, or payment levels other than those established by a fixed, predetermined schedule at the time of contracting for the loan.

(2) [Reserved]

(3) *Applicant* means a natural person (or persons) making a loan application.

(4) *Home* means real estate as defined by § 541.14 of this chapter, manufactured housing, combinations of homes and business property, and farm residences or combinations of farm residences and commercial farm real estate.

(b) *Initial disclosures for adjustable-rate mortgage loans*. Savings associations offering adjustable-rate home loans, except open-end loans, with a term of more than one (1) year and secured by property occupied or to be occupied by the borrower, shall provide two types of written disclosure to prospective borrowers when an application form is provided or before the payment of a non-refundable fee, whichever is earlier:

(1) The booklet titled Consumer Handbook on Adjustable Rate Mortgages published by the Office and the Federal Reserve Board, or a suitable substitute (Available at the address listed in § 516.1 of this chapter.).

(2) A loan program disclosure for each adjustable-rate home loan program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided: n2

n2 A sample disclosure form may be found in the **Federal Register** issue of May 23, 1988 *(53 FR 18262)* or may be obtained from the Office at the address listed in § 516.1 of this chapter.

(i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the use of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) An historical example, based on a $ 10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. The example shall be based upon index values beginning in 1977 and be updated annually until a 15-year history is shown. Thereafter, the example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limitations, that would have been affected by the index movement during the period.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.

(x) The maximum interest rate and payment for a $ 10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan.

(xi) The fact that the loan program contains a demand feature.

(xii) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xiii) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

(c) *Adjustment notices*. An adjustment to the interest rate with or without a corresponding adjustment to the payment in an adjustable-rate transaction subject to this section is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a payment at a new level is due, the following written disclosures, as applicable, must be delivered or placed in the mail:

(1) The current and prior interest rates.

(2) The index values upon which the current and prior interest rates are based.

(3) The extent to which the creditor has foregone any increase in the interest rate.

(4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance.

(5) The payment, if different from that referred to in paragraph (c)(4) of this section, that would be required to amortize fully the loan at the new interest rate over the remainder of the loan term.

(d) [Reserved]

(e) *Maximum interest rate caps.* All savings associations making adjustable-rate loans, originated on or after December 8, 1987, whether open-end or closed-end, shall comply with Regulation Z (*12 CFR 226.30*) by specifying in their credit contracts the maximum interest rate that may be imposed during the term of the obligation.

(f) *Exception.* The disclosures in paragraph (b) of this section are not required in connection with the extension of consumer credit as defined in § 561.12 of this chapter even if it is secured by a borrower-occupied home as long as the home is not the primary security for the loan.

(g) *Exempt transactions.* This section does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose.

§ 560.220 -- Alternative Mortgage Parity Act.

Pursuant to *12 U.S.C. 3803,* housing creditors that are not commercial banks, credit unions, or Federal savings associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, *12 U.S.C. 3801* note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable. **[*50984]**

PART 563--OPERATIONS

10. The authority citation for part 563 continues to read as follows:

Authority: *12 U.S.C. 375b,* 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1828, 3806.

§ 563.51 -- [Amended]

11. Section 563.51(f)(1)(i) is amended by removing the phrase "§ 545.45(a)(1)", and by adding in lieu thereof the phrase "§ 560.30".

Subpart D of Part 563--[Removed and Reserved]

12. Subpart D of part 563 is removed and reserved.

§ 563.160 -- [Removed]

13. Section 563.160 is removed.

14. Section 563.170 is amended by revising paragraph (c) to read as follows:

§ 563.170 -- Examinations and audits; appraisals; establishment and maintenance of records.

* * * * *

(c) *Establishment and maintenance of records.* To enable the Office to examine savings associations and affiliates and audit savings associations, affiliates, and service corporations pursuant to the provisions of paragraph (a) of this section, each savings association, affiliate, and service corporation shall establish and maintain such accounting and other records as will provide an accurate and complete record of all business it transacts. This includes, without limitation, establishing and maintaining such other records as are required by statute or any other regulation to which the savings association, affiliate, or service corporation is subject. The documents, files, and other material or property comprising said records shall at all times be available for such examination and audit wherever any of said records, documents, files, material, or property may be.

* * * * *

§ 563.172 -- [Removed]

15. Section 563.172 is removed.

PART 566--LIQUIDITY

16. The authority citation for part 566 continues to read as follows:

Authority: *12 U.S.C. 1462*, 1462a, 1463, 1464, 1465, 1467a; *15 U.S.C. 1691*, 1691a.

§ 566.1 -- [Amended]

17. Section 566.1(g)(6)(i) is amended by removing the phrase "§ 545.72(a)", and by adding in lieu thereof the phrase "§ 560.42".

PART 571--STATEMENTS OF POLICY

18. The authority citation for part 571 continues to read as follows:

Authority: *5 U.S.C. 552*, 559; *12 U.S.C. 1462a*, 1463, 1464.

§§ 571.8, 571.13, 571.20, 571.22 -- [Removed]

19. Sections 571.8, 571.13, 571.20, and 571.22 are removed.

PART 590--PREEMPTION OF STATE USURY LAWS

20. The authority citation for part 590 continues to read as follows:

Authority: *12 U.S.C. 1735f-7a.*

§ 590.4 -- [Amended]

21. Section 590.4(e)(1) is amended by removing the phrase "§ 545.33(f)", and by adding in lieu thereof the phrase "§ 560.220".

Dated: September 11, 1996.

By the Office of Thrift Supervision.

John F. Downey,

Executive Director, Supervision.

[FR Doc. 96-23726 Filed 9-27-96; 8:45 am]

BILLING CODE 6720-01 P

ADDENDUM TAB H

LEXSEE 69 FR 1904

FEDERAL REGISTER
Vol. 69, No. 8

Rules and Regulations

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency (OCC)

12 CFR Parts 7 and 34

[Docket No. 04-04]

RIN 1557-AC73

Bank Activities and Operations; Real Estate Lending and Appraisals

69 FR 1904

DATE: Tuesday, January 13, 2004

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) n1 and regulations issued thereunder, in connection with all types of lending.

n1 *15 U.S.C. 45*(a)(1).

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 **[*1905]** 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 thereunder n2 similarly appears in both parts 34 and 7.

n2 12 CFR part 227.

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. n3 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.

n3 Prior *12 CFR 34.1(b)* and *34.4(a).*

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), n4 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) n5 and the Equal Credit Opportunity Act (ECOA). n6

n4 *12 CFR 560.2.*

n5 *15 U.S.C. 1601 et seq.*

n6 *15 U.S.C. 1691 et seq.*

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. n7 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.

n7 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.

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; n8 section 5 of the FTC Act, n9 which makes unlawful "unfair or deceptive acts or practices" in interstate commerce; and many other Federal laws that impose standards on lending practices. n10 The NPRM invited commenters to suggest other anti-predatory lending standards that would be appropriate to apply to national bank real estate lending activities.

n8 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*.

n9 *15 U.S.C. 45*(a)(1).

n10 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.*

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. **[*1906]**

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 activities n11 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.

n11 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.

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 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. n12 The remaining issues raised by the state commenters are addressed in sections IV and VI of this preamble. n13

n12 *See also* OCC publication entitled *National Banks and the Dual Banking System* (Sept. 2003).

n13 *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 D. Hawke, Jr., Comptroller of the Currency, to Representatives Sue Kelly, Peter King, Carolyn B. Maloney, and Carolyn McCarthy (Dec. 23, 2003). **[*1907]**

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. n14 These commenters concluded that this broad grant of Federal powers, coupled with equally broad grants of rulemaking authority to the OCC, n15 effectively occupy the field of national bank regulation.

n14 *See, e.g., Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 258 n.2 (1995)* (VALIC).

n15 *See, e.g., 12 U.S.C. 93a.*

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." n16 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.

n16 *68 FR 46119, 46120.*

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. n17 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, n18 enable national banks to evolve their operations in order to meet the changing needs of our economy and individual consumers. n19

n17 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.

n18 *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).

n19 The Supreme Court expressly affirmed the dynamic, evolutionary character of national bank powers in *VALIC*, in which it held that the "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.*

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" n20 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. n21

n20 *12 U.S.C. 93a.*

n21 *12 U.S.C. 371*(a).

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 on-line. 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 **[*1908]** 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. n22 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.

n22 *see* S. Rep. No. 108-166, at 10 (2003) (quoting the hearing testimony of Secretary of the Treasury Snow).

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. n23 When national banks are unable to operate under national standards, it also implicates the role and responsibilities of the OCC.

n23 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).

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. n24 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.

n24 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.

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), n25 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.

n25 *see 68 FR 46264* (Aug. 5, 2003).

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. n26

n26 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).

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 * * *. n27

n27 *12 U.S.C. 93a.*

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 **[*1909]** 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*, n28 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.

n28 *710 F.2d 878 (D.C. Cir. 1983).*

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." n29

n29 *Id. at 885* (emphasis in original).

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.* n30

n30 *Id.* (emphasis in original).

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. n31

n31 *Id*.

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.* n32

n32 *Id. at 878* (emphasis added).

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*, n33 *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. n34

n33 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.*

n34 *12 U.S.C. 371*(a).

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." n35 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*.

n35 *Id.* As noted *supra* at note 7, Federal legislation occasionally provides that national banks shall conduct certain activities subject to state law 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.

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, n36 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." n37 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.

n36 Federal Reserve Act, Dec. 23, 1913, ch. 6, 38 Stat. 251, as amended.

n37 *Id.* section 24, 38 Stat. 273.

In 1982, Congress removed these "rigid statutory limitations" n38 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." n39 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." n40 In 1991, Congress removed the term "rule" from this phrase and enacted an additional requirement, codified at *12 U.S.C.* **[*1910]** *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. n41

n38 S. Rep. No. 97-536, at 27 (1982).

n39 Garn-St Germain Depository Institutions Act of 1982, Pub. L. 97-320, section 403, 96 Stat. 1469, 1510-11 (1982).

n40 S. Rep. No. 97-536, at 27 (1982).

n41 *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.

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-n*amely, 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. n42 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. n43 Second, Congress can adopt a framework for regulation that "occupies the field" and leaves no room for states to adopt supplemental laws. n44 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;" n45 or (ii) when the state law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." n46

n42 "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.

n43 *See Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977).*

n44 *See Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).*

n45 *Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 143 (1963).*

n46 *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*).

In *Barnett Bank of Marion County* v. *Nelson,* n47 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.

n47 *517 U.S. 25 (1996).*

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. Luckett, 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"). n48

n48 *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."

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:* n49

n49 *312 U.S. 52 (1941).*

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. n50

n50 *Id. at 67* (emphasis added) (citations omitted).

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, n51 impair, n52 or condition n53 "-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.

n51 *See Hines, 312 U.S. at 76.*

n52 *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.*

n53 *See Barnett, 517 U.S. at 34; Franklin Nat'l Bank of Franklin Square v. New York, 347 U.S. 373, 375-79 (1954).*

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 **[*1911]** 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, n54 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. n55

n54 *15 U.S.C. 45*(a)(1).

n55 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).

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. n56

n56 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).*

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. n57

n57 *See, e.g.*, OCC Determination and Order concerning the Georgia Fair Lending Act, *supra* footnote 25.

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 **[*1912]** 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, n58 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. n59 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.

n58 *See Bank of America v. City & County of San Francisco, 309 F.3d 551, 559 (9th Cir. 2002).*

n59 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.

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, n60 we have revised the language of the final rule to refer to national banks' "right to collect debts."

n60 *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).*

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, n61 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.

n61 *See supra* note 10.

In § 7.4009, the final rule first states that national banks may exercise all powers authorized to them under Federal law. n62 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. n63 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."

n62 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 visitorial authority), and *12 U.S.C. 93a* (OCC authority to issue regulations).

n63 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.

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 **[*1913]** law, n64 or it may incorporate-or "Federalize"-state standards. n65 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." n66 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.

n64 *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).

n65 *See, e.g., 12 U.S.C. 92a* (permissible fiduciary activities for national banks determined by reference to state law).

n66 *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).

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). n67 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.

n67 For a detailed discussion of this issue, *see* the OCC's visitorial powers rulemaking also published today in the **Federal Register**.

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. We will not tolerate such practices by national banks and their operating subsidiaries. Our Advisory Letters on predatory lending, n68 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.

n68 *See supra* note 8.

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,* n69 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. n70 n69 Enforcement Action 2000-53 (June 28, 2000), *available* at the OCC's Web site in the "Popular FOIA Requests" section at *http://www.occ.treas.gov/foia/foiadocs.htm.*

n70 *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.*

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. n71

n71 *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 that 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).

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. n72

n72 *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- 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.* **[*1914]**

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, n73 and even with comments submitted in connection with an OTS rulemaking concerning preemption of state lending standards by *46* State Attorneys General.

n73 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.

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*. n74

n74 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).

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" n75 between its supervised institutions and state housing creditors.

n75 *Id.* at 10.

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*). n76

n76 National Association of Attorneys General comment letter on the proposal at 10 (Oct. 6, 2003) (emphasis added).

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 **[*1915]** 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 **[*1916]** 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; n3

n3 This does not apply to state laws of the type upheld by the United States Supreme Court in *Anderson Nat'l Bank v. Luckett, 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.*

(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; n4

n4 State laws purporting to regulate national bank fees and charges are addressed in *12 CFR 7.4002.*

(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; n5

n5 *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).

(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 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. n6

n6 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*.

(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; n7

n7 *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 offences cognizable under the authority of the United States."

(4) Rights to collect debts;

(5) Acquisition and transfer of property;

(6) Taxation;

(7) Zoning; and **[*1917]**

(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 law n8

n8 8 *Id.*

(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; n1

n1 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*.

(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; n2

n2 *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).

(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.

[FR Doc. 04-586 Filed 1-12-04; 8:45 am]

BILLING CODE 4810-33-P

ADDENDUM TAB I

LEXSTAT UCC SEC 9-610

UNIFORM COMMERCIAL CODE

ARTICLE 9. SECURED TRANSACTIONS
PART 6. DEFAULT
SUBPART 1. DEFAULT AND ENFORCEMENT OF SECURITY INTEREST

U.C.C. § 9-610

9-610. DISPOSITION OF COLLATERAL AFTER DEFAULT

(a) **[Disposition after default.]** After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) **[Commercially reasonable disposition.]** Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) **[Purchase by secured party.]** A secured party may purchase collateral:

(1) at a public disposition; or

(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) **[Warranties on disposition.]** A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) **[Disclaimer of warranties.]** A secured party may disclaim or modify warranties under subsection (d):

(1) in a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(2) by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) **[Record sufficient to disclaim warranties.]** A record is sufficient to disclaim warranties under subsection (e) if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

NOTES:
OFFICIAL COMMENT
1. **Source.** Former Section 9-504(1), (3)
2. **Commercially Reasonable Dispositions.** Subsection (a) follows former Section 9-504 by permitting a secured party to dispose of collateral in a commercially reasonable manner following a default. Although subsection (b) permits both public and private dispositions, "every aspect of a disposition . . . must be commercially reasonable." This section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned. Subsection (a) does not restrict dispositions to sales; collateral may be sold, leased, li-

censed, or otherwise disposed. Section 9-627 provides guidance for determining the circumstances under which a disposition is "commercially reasonable."

3. **Time of Disposition.** This Article does not specify a period within which a secured party must dispose of collateral. This is consistent with this Article's policy to encourage private dispositions through regular commercial channels. It may, for example, be prudent not to dispose of goods when the market has collapsed. Or, it might be more appropriate to sell a large inventory in parcels over a period of time instead of in bulk. Of course, under subsection (b) every aspect of a disposition of collateral must be commercially reasonable. This requirement explicitly includes the "method, manner, time, place and other terms." For example, if a secured party does not proceed under Section 9-620 and holds collateral for a long period of time without disposing of it, and if there is no good reason for not making a prompt disposition, the secured party may be determined not to have acted in a "commercially reasonable" manner. See also Section 1-203 (general obligation of good faith).

4. **Pre-Disposition Preparation and Processing.** Former Section 9-504(1) appeared to give the secured party the choice of disposing of collateral either "in its then condition or following any commercially reasonable preparation or processing." Some courts held that the "commercially reasonable" standard of former Section 9-504(3) nevertheless could impose an affirmative duty on the secured party to process or prepare the collateral prior to disposition. Subsection (a) retains the substance of the quoted language. Although courts should not be quick to impose a duty of preparation or processing on the secured party, subsection (a) does not grant the secured party the right to dispose of the collateral "in its then condition" under *all* circumstances. A secured party may not dispose of collateral "in its then condition" when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in that condition.

5. **Disposition by Junior Secured Party.** Disposition rights under subsection (a) are not limited to first-priority security interests. Rather, any secured party as to whom there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest. Section 9-615 addresses application of the proceeds of a disposition by a junior secured party. Under Section 9-615(a), a junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of obligations secured by a senior security interest. Section 9-615(g) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a non-Article 9 claim to proceeds of a junior's disposition, Section 9-615(g) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Because the disposition by a junior would not cut off a senior's security interest or other lien (see Section 9-617), in many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior.

The holder of a senior security interest is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See Section 9-609. The holder of a junior security interest normally must notify the senior secured party of an impending disposition. See Section 9-611. Regardless of whether the senior receives a notification from the junior, the junior's disposition does not of itself discharge the senior's security interest. See Section 9-617. Unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will survive the disposition by the junior and continue under Section 9-315(a). If the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or other lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine "rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." *Meyer v. United States, 375 U.S. 233, 236 (1963)*, quoting *Sowell v. Federal Reserve Bank, 268 U.S. 449, 456-57 (1925).* The purpose of the doctrine is "to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security." Id. at 237. Because it is an equitable doctrine, marshaling "is applied only when it can be equitably fashioned as to all of the parties" having an interest in the property. Id. This Article leaves courts free to determine whether marshaling is appropriate in any given case. See Section 1-103.

6. **Security Interests of Equal Rank.** Sometimes two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to "equal and ratable" provisions in indentures, or by operation of law. See Section 9-328(6). This Article treats a security interest having equal priority like a senior security interest in many respects. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (i) SP-W's and SP-Y's security interests survive the disposition but SP-Z's

does not, see Section 9-617, and (ii) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds, but SP-Z is. See Section 9-615(a)(3).

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-609, Comment 5. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

7. **Public vs. Private Dispositions.** This Part maintains two distinctions between "public" and other dispositions: (i) the secured party may buy at the former, but normally not at the latter (Section 9-610(c)), and (ii) the debtor is entitled to notification of "the time and place of a public disposition" and notification of "the time after which" a private disposition or other intended disposition is to be made (Section 9-613(1)(E)). It does not retain the distinction under former Section 9-504(4), under which transferees in a noncomplying public disposition could lose protection more easily than transferees in other noncomplying dispositions. Instead, Section 9-617(b) adopts a unitary standard. Although the term is not defined, as used in this Article, a "public disposition" is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity" is meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition).

8. **Investment Property.** Dispositions of investment property may be regulated by the federal securities laws. Although a "public" disposition of securities under this Article may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for a "private placement" exemption under the Securities Act of 1933 nevertheless may constitute a "public" disposition within the meaning of this section. Moreover, the "commercially reasonable" requirements of subsection (b) need not prevent a secured party from conducting a foreclosure sale without the issuer's compliance with federal registration requirements.

9. **"Recognized Market."** A "recognized market," as used in subsection (c) and Section 9-611(d), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.

10. **Relevance of Price.** While not itself sufficient to establish a violation of this Part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable. Note also that even if the disposition is commercially reasonable, Section 9-615(f) provides a special method for calculating a deficiency or surplus if (i) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor, and (ii) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

11. **Warranties.** Subsection (d) affords the transferee in a disposition under this section the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of non-Article 9 law had the disposition been conducted under other circumstances. For example, the Article 2 warranty of title would apply to a sale of goods, the analogous warranties of Article 2A would apply to a lease of goods, and any common-law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d), Contracts § 333 (warranties of assignor).

Subsection (e) explicitly provides that these warranties can be disclaimed either under other applicable law or by communicating a record containing an express disclaimer. The record need not be written, but an oral communication would not be sufficient. See Section 9-102 (definition of "record"). Subsection (f) provides a sample of wording that will effectively exclude the warranties in a disposition under this section, whether or not the exclusion would be effective under non-Article 9 law.

The warranties incorporated by subsection (d) are those relating to "title, possession, quiet enjoyment, and the like." Depending on the circumstances, a disposition under this section also may give rise to other statutory or implied warranties, e.g., warranties of quality or fitness for purpose. Law other than this Article determines whether such other warranties apply to a disposition under this section. Other law also determines issues relating to disclaimer of such warranties. For example, a foreclosure sale of a car by a car dealer could give rise to an implied warranty of merchantability (Section 2-314) unless effectively disclaimed or modified (Section 2-316).

This section's approach to these warranties conflicts with the former Comment to Section 2-312. This Article rejects the baseline assumption that commercially reasonable dispositions under this section are out of the ordinary commercial course or peculiar. The Comment to Section 2-312 has been revised accordingly.

Emerging Issues Analysis

Professor Margit Livingston on JCB, Inc. v. Union Planters Bank, NA: Creditor Liability for Trespass and Conversion

In the current financial crisis, business and consumer debtors are finding themselves unable to keep up with installment payments to their secured creditors and are defaulting. Upon the debtor's default, a secured party has the right to repossess the collateral. However, junior secured parties need to remember to be cautious in disposing of collateral subject to a senior security interest.

ADDENDUM TAB J

LEXSTAT UCC SEC 9-611

UNIFORM COMMERCIAL CODE

ARTICLE 9. SECURED TRANSACTIONS
PART 6. DEFAULT
SUBPART 1. DEFAULT AND ENFORCEMENT OF SECURITY INTEREST

U.C.C. § 9-611

9-611. NOTIFICATION BEFORE DISPOSITION OF COLLATERAL

(a) **["Notification date."]** In this section, "notification date" means the earlier of the date on which:

(1) a secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(2) the debtor and any secondary obligor waive the right to notification.

(b) **[Notification of disposition required.]** Except as otherwise provided in subsection (d), a secured party that disposes of collateral under Section 9-610 shall send to the persons specified in subsection (c) a reasonable authenticated notification of disposition.

(c) **[Persons to be notified.]** To comply with subsection (b), the secured party shall send an authenticated notification of disposition to:

(1) the debtor;

(2) any secondary obligor; and

(3) if the collateral is other than consumer goods:

(A) any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

(B) any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(i) identified the collateral;

(ii) was indexed under the debtor's name as of that date; and

(iii) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(C) any other secured party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(d) **[Subsection (b) inapplicable: perishable collateral; recognized market.]** Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

(e) **[Compliance with subsection (c)(3)(B).]** A secured party complies with the requirement for notification prescribed by subsection (c)(3)(B) if:

(1) not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (c)(3)(B); and

(2) before the notification date, the secured party:

(A) did not receive a response to the request for information; or

(B) received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

NOTES:
OFFICIAL COMMENT

1. **Source.** Former Section 9-504(3).

2. **Reasonable Notification.** This section requires a secured party who wishes to dispose of collateral under Section 9-610 to send "a reasonable authenticated notification of disposition" to specified interested persons, subject to certain exceptions. The notification must be reasonable as to the manner in which it is sent, its timeliness (i.e., a reasonable time before the disposition is to take place), and its content. See Sections 9-612 (timeliness of notification), 9-613 (contents of notification generally), 9-614 (contents of notification in consumer-goods transactions).

3. **Notification to Debtors and Secondary Obligors.** This section imposes a duty to send notification of a disposition not only to the debtor but also to any secondary obligor. Subsections (b) and (c) resolve an uncertainty under former Article 9 by providing that secondary obligors (sureties) are entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be a secondary obligor. (This Article also resolves the question of the secondary obligor's ability to waive, pre-default, the right to notification-waiver generally is not permitted. See Section 9-602.) Section 9-605 relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

Under subsection (b), the principal obligor (borrower) is not always entitled to notification of disposition.

Example: Behnfeldt borrows on an unsecured basis, and Bruno grants a security interest in her car to secure the debt. Behnfeldt is a primary obligor, not a secondary obligor. As such, she is not entitled to notification of disposition under this section.

4. **Notification to Other Secured Parties.** Prior to the 1972 amendments to Article 9, former Section 9-504(3) required the enforcing secured party to send reasonable notification of the disposition:

except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral.

The 1972 amendments eliminated the duty to give notice to secured parties other than those from whom the foreclosing secured party had received written notice of a claim of an interest in the collateral.

Many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. To this end, subsection (c)(3)(B) expands the duties of the foreclosing secured party to include the duty to notify (and the corresponding burden of searching the files to discover) certain competing secured parties. The subsection imposes a search burden that in some cases may be greater than the pre-1972 burden on foreclosing secured parties but certainly is more modest than that faced by a new secured lender.

To determine who is entitled to notification, the foreclosing secured party must determine the proper office for filing a financing statement as of a particular date, measured by reference to the "notification date," as defined in subsection (a). This determination requires reference to the choice-of-law provisions of Part 3. The secured party must ascertain whether any financing statements covering the collateral and indexed under the debtor's name, as the name existed as of that date, in fact were filed in that office. The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor's name.

Under subsection (c)(3)(C), the secured party also must notify a secured party who has perfected a security interest by complying with a statute or treaty described in Section 9-311(a), such as a certificate-of-title statute.

Subsection (e) provides a "safe harbor" that takes into account the delays that may be attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duty under subsection (c)(3)(B) if it requests a search from the proper office at least 20 but not more than 30 days before sending notification to the debtor and if it also sends a notification to all secured parties (and other lienholders) reflected on the search report. The secured party's duty under subsection (c)(3)(B) also will be satisfied if the secured party requests but does not receive a search report before the notification is sent to the debtor. Thus, if subsection (e) applies, a secured party who is entitled to notification under subsection (c)(3)(B) has no remedy against a foreclosing secured party who does not send the notification. The foreclosing secured party has complied with the notification requirement. Subsection (e) has no effect on the requirements of the other paragraphs of subsection (c). For example, if the foreclosing secured party received a notification from the holder of a conflicting security interest in accordance with subsection (c)(3)(A) but failed to send to the holder a notification of the disposition, the holder of the conflicting security interest would have the right to recover any loss under Section 9-625(b).

5. **Authentication Requirement.** Subsections (b) and (c) explicitly provide that a notification of disposition must be "authenticated." Some cases read former Section 9-504(3) as validating oral notification.

6. **Second Try.** This Article leaves to judicial resolution, based upon the facts of each case, the question whether the requirement of "reasonable not ification" requires a "second try," i.e., whether a secured party who sends notification and learns that the debtor did not receive it must attempt to locate the debtor and send another notification.

7. **Recognized Market; Perishable Collateral.** New subsection (d) makes it clear that there is no obligation to give notification of a disposition in the case of perishable collateral or collateral customarily sold on a recognized market (e.g., marketable securities). Former Section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to notify a debtor but not from its duty to notify other secured parties in connection with dispositions of such collateral.

8. **Failure to Conduct Notified Disposition.** Nothing in this Article prevents a secured party from electing not to conduct a disposition after sending a notification. Nor does this Article prevent a secured party from electing to send a revised notification if its plans for disposition change. This assumes, however, that the secured party acts in good faith, the revised notification is reasonable, and the revised plan for disposition and any attendant delay are commercially reasonable.

9. **Waiver.** A debtor or secondary obligor may waive the right to notification under this section only by a post-default authenticated agreement. See Section 9-624(a).

Emerging Issues Analysis

Professor Margit Livingston on Punishing Creditor Misbehavior in U.C.C. Article 9 Foreclosure Sales

In the current recessionary climate, more and more secured creditors are faced with the prospect of defaults by their debtors and the need to proceed with foreclosure of their security interests. Article 9 of the Uniform Commercial Code requires secured parties undertaking foreclosure sales to follow certain procedures or risk losing their ability to receive a deficiency judgment against the debtor.

ADDENDUM TAB K

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LEXSTAT U.C.C. § 9-613

ARTICLE 9. SECURED TRANSACTIONS
PART 6. DEFAULT
SUBPART 1. DEFAULT AND ENFORCEMENT OF SECURITY INTEREST

U.C.C. § 9-613

9-613. CONTENTS AND FORM OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL: GENERAL

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:

(A) describes the debtor and the secured party;

(B) describes the collateral that is the subject of the intended disposition;

(C) states the method of intended disposition;

(D) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and

(E) states the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in paragraph (1) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) are sufficient, even if the notification includes:

(A) information not specified by that paragraph; or

(B) minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in Section 9-614(3), when completed, each provides sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: ___ [*Name of debtor, obligor, or other person to which the notification is sent*]

From: ___ [*Name, address, and telephone number of secured party*]

Name of Debtor(s): ___ [*Include only if debtor(s) are not an addressee*]

[*For a public disposition:*]

We will sell [or lease or license, *as applicable*] the ___ [*describe collateral*] [to the highest qualified bidder] in public as follows:

Day and Date: ___

Time: ___

Place: ___

[*For a private disposition:*]

We will sell [or lease or license, *as applicable*] the ___ [*describe collateral*] privately sometime after ___ [*day and date*].

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, *as applicable*] [for a charge of $ ___]. You may request an accounting by calling us at ___ [*telephone number*]

[End of Form]

NOTES:
OFFICIAL COMMENT

1. **Source.** New.
2. **Contents of Notification.** To comply with the "reasonable authenticated notification" requirement of Section 9-611(b), the contents of a notification must be reasonable. Except in a consumer-goods transaction, the contents of a notification that includes the information set forth in paragraph (1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to "time" of disposition means here, as it did in former Section 9-504(3), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be reasonable by the trier of fact, under paragraph (2). A properly completed sample form of notification in paragraph (5) or in Section 9-614(a)(3) is an example of a notification that would contain the information set forth in paragraph (1). Under paragraph (4), however, no particular phrasing of the notification is required.

ADDENDUM TAB L

LEXSTAT U.C.C. § 9-614

UNIFORM COMMERCIAL CODE

ARTICLE 9. SECURED TRANSACTIONS
PART 6. DEFAULT
SUBPART 1. DEFAULT AND ENFORCEMENT OF SECURITY INTEREST

U.C.C. § 9-614

9-614. CONTENTS AND FORM OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL: CONSUMER-GOODS TRANSACTION

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

(A) the information specified in Section 9-613(1);

(B) a description of any liability for a deficiency of the person to which the notification is sent;

(C) a telephone number from which the amount that must be paid to the secured party to redeem the collateral under Section 9-623 is available; and

(D) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

___ [*Name and address of secured party*]

___ [*Date*]

NOTICE OF OUR PLAN TO SELL PROPERTY

___ [*Name and address of any obligor who is also a debtor*]

Subject: ___ [*Identification of Transaction*]

We have your ___ [*describe collateral*], because you broke promises in our agreement.

[*For a public disposition:*]

We will sell ___ [*describe collateral*] at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: ___

Time: ___

Place: ___

You may attend the sale and bring bidders if you want.

[*For a private disposition:*]

We will sell ___ [*describe collateral*] at private sale sometime after ___ [*date*]. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you ___ [*will or will not, as applicable*] still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at ___ [*telephone number*].

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at ___ [*telephone number*] [or write us at ___ [*secured party's address*]] and request a written explanation. [We will charge you $ ___ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at ___ [*telephone number*]] [or write us at ___ [*secured party's address*]].

We are sending this notice to the following other people who have an interest in ___ [*describe collateral*] or who owe money under your agreement:

___ [*Names of all other debtors and obligors, if any*]

[End of Form]

(4) A notification in the form of paragraph (3) is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of paragraph (3) is sufficient, even if it includes errors in information not required by paragraph (1), unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of paragraph (3), law other than this article determines the effect of including information not required by paragraph (1).

NOTES:

OFFICIAL COMMENT

1. **Source.** New.

2. **Notification in Consumer-Goods Transactions.** Paragraph (1) sets forth the information required for a reasonable notification in a consumer-goods transaction. A notification that lacks any of the information set forth in paragraph (1) is insufficient as a matter of law. Compare Section 9-613(2), under which the trier of fact may find a notification to be sufficient even if it lacks some information listed in paragraph (1) of that section.

3. **Safe-Harbor Form of Notification; Errors in Information.** Although paragraph (2) provides that a particular phrasing of a notification is not required, paragraph (3) specifies a safe-harbor form that, when properly completed, satisfies paragraph (1). Paragraphs (4), (5), and (6) contain special rules applicable to erroneous and additional information. Under paragraph (4), a notification in the safe-harbor form specified in paragraph (3) is not rendered insufficient if it contains additional information at the end of the form. Paragraph (5) provides that non-misleading errors in information contained in a notification are permitted if the safe-harbor form is used *and if the errors are in information not required by paragraph (1)*. Finally, if a notification is in a form other than the paragraph (3) safe-harbor form, other law determines the effect of including in the notification information other than that required by paragraph (1).

ADDENDUM TAB M

LEXSTAT U.C.C. § 9-615

UNIFORM COMMERCIAL CODE

ARTICLE 9. SECURED TRANSACTIONS
PART 6. DEFAULT
SUBPART 1. DEFAULT AND ENFORCEMENT OF SECURITY INTEREST

U.C.C. § 9-615

9-615. APPLICATION OF PROCEEDS OF DISPOSITION; LIABILITY FOR DEFICIENCY AND RIGHT TO SURPLUS

(a) **[Application of proceeds.]** A secured party shall apply or pay over for application the cash proceeds of disposition under Section 9-610 in the following order to:

(1) the reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) the satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) the satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

(A) the secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

(B) in a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(4) a secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) **[Proof of subordinate interest.]** If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (a)(3).

(c) **[Application of noncash proceeds.]** A secured party need not apply or pay over for application noncash proceeds of disposition under Section 9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) **[Surplus or deficiency if obligation secured.]** If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) and permitted by subsection (c):

(1) unless subsection (a)(4) requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) the obligor is liable for any deficiency.

(e) **[No surplus or deficiency in sales of certain rights to payment.]** If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(1) the debtor is not entitled to any surplus; and

(2) the obligor is not liable for any deficiency.

(f) **[Calculation of surplus or deficiency in disposition to person related to secured party.]** The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(1) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(2) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) **[Cash proceeds received by junior secured party.]** A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) takes the cash proceeds free of the security interest or other lien;

(2) is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

NOTES:

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(1), (2).

2. **Application of Proceeds.** This section contains the rules governing application of proceeds and the debtor's liability for a deficiency following a disposition of collateral. Subsection (a) sets forth the basic order of application. The proceeds are applied first to the expenses of disposition, second to the obligation secured by the security interest that is being enforced, and third, in the specified circumstances, to interests that are subordinate to that security interest.

Subsections (a) and (d) also address the right of a consignor to receive proceeds of a disposition by a secured party whose interest is senior to that of the consignor. Subsection (a) requires the enforcing secured party to pay excess proceeds first to subordinate secured parties or lienholders whose interests are senior to that of a consignor and, finally, to a consignor. Inasmuch as a consignor is the owner of the collateral, secured parties and lienholders whose interests are junior to the consignor's interest will not be entitled to any proceeds. In like fashion, under subsection (d)(1) the debtor is not entitled to a surplus when the enforcing secured party is required to pay over proceeds to a consignor.

3. **Noncash Proceeds.** Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in Section 9-608, Comment 4, generally applies to this subsection.

Example: A secured party in the business of selling or financing automobiles takes possession of collateral (an automobile) following its debtor's default. The secured party decides to sell the automobile in a private disposition under Section 9-610 and sends appropriate notification under Section 9-611. After undertaking its normal credit investigation and in accordance with its normal credit policies, the secured party sells the automobile on credit, on terms typical of the credit terms normally extended by the secured party in the ordinary course of its business. The automobile stands as collateral for the remaining balance of the price. The noncash proceeds received by the secured party are chattel paper. The secured party may wish to credit its debtor (the assignor) with the principal amount of the chattel paper or may wish to credit the debtor only as and when the payments are made on the chattel paper by the buyer.

Under subsection (c), the secured party is under no duty to apply the noncash proceeds (here, the chattel paper) or their value to the secured obligation unless its failure to do so would be commercially unreasonable. If a secured party elects to apply the chattel paper to the outstanding obligation, however, it must do so in a commercially reasonable manner. The facts in the example indicate that it would be commercially unreasonable for the secured party to fail to apply the value of the chattel paper to the original debtor's secured obligation. Unlike the example in Comment 4 to Section 9-608, the noncash proceeds received in this example are of the type that the secured party regularly generates in the ordinary course of its financing business in nonforeclosure transactions. The original debtor should not be exposed to delay or uncertainty in this situation. Of course, there will be many situations that fall between the examples presented in the Comment to Section 9-608 and in this Comment. This Article leaves their resolution to the court based on the facts of each case.

One would expect that where noncash proceeds are or may be material, the secured party and debtor would agree to more specific standards in an agreement entered into before or after default. The parties may agree to the method of application of noncash proceeds if the method is not manifestly unreasonable. See Section 9-603.

When the secured party is not required to "apply or pay over for application noncash proceeds," the proceeds nonetheless remain collateral subject to this Article. See Section 9-608, Comment 4.

4. **Surplus and Deficiency.** Subsection (d) deals with surplus and deficiency. It revises former Section 9-504(2) by imposing an explicit requirement that the secured party "pay" the debtor for any surplus, while retaining the secured party's duty to "account." Inasmuch as the debtor may not be an obligor, subsection (d) provides that the obligor (not the debtor) is liable for the deficiency. The special rule governing surplus and deficiency when receivables have been sold likewise takes into account the distinction between a debtor and an obligor. Subsection (d) also addresses the situation in which a consignor has an interest that is subordinate to the security interest being enforced.

5. **Collateral Under New Ownership.** When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest in the collateral; the buyer is the debtor. See Section 9-102. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus following a disposition. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But, because this situation typically arises as a result of the debtor's wrongful act, this Article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the buyer and accordingly pays the surplus to the original debtor, the exculpatory provisions of this Article exonerate the secured party from liability to the buyer. See Sections 9-605, 9-628(a), (b). If a debtor sells collateral *free* of a security interest, as in a sale to a buyer in ordinary course of business (see Section 9-320(a)), the property is no longer collateral and the buyer is not a debtor.

6. **Certain "Low-Price" Dispositions.** Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, a person related to the secured party (defined in Section 9-102), or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this Article (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price.

Subsection (f) adjusts for this lack of incentive. If the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought," then instead of calculating a deficiency (or surplus) based on the actual net proceeds, the calculation is based upon the amount that would have been received in a commercially reasonable disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor. Subsection (f) thus rejects the view that the secured party's receipt of such a price necessarily constitutes noncompliance with Part 6. However, such a price may suggest the need for greater judicial scrutiny. See Section 9-610, Comment 10.

7. **"Person Related To."** Section 9-102 defines "person related to." That term is a key element of the system provided in subsection (f) for low-price dispositions. One part of the definition applies when the secured party is an individual, and the other applies when the secured party is an organization. The definition is patterned closely on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code.

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ADDENDUM TAB N

*** THIS DOCUMENT IS CURRENT THROUGH 2009-2010 EXTRAORDINARY SESSIONS 1-5, ***
7, AND 8, AND URGENCY LEGISLATION THROUGH CH 17 OF THE 2010 REGULAR SESSION

CIVIL CODE
Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 14. Lien
Chapter 2b. Automobile Sales Finance Act

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 2983.2 (2010)

§ 2983.2. Notice of intent to dispose of repossessed or surrendered motor vehicle; Accounting regarding disposition

(a) Except where the motor vehicle has been seized as described in paragraph (6) of subdivision (b) of Section 2983.3, any provision in any conditional sale contract for the sale of a motor vehicle to the contrary notwithstanding, at least 15 days' written notice of intent to dispose of a repossessed or surrendered motor vehicle shall be given to all persons liable on the contract. The notice shall be personally served or shall be sent by certified mail, return receipt requested, or first-class mail, postage prepaid, directed to the last known address of the persons liable on the contract. If those persons are married to each other, and, according to the most recent records of the seller or holder of the contract, reside at the same address, one notice addressed to both persons at that address is sufficient. Except as otherwise provided in Section 2983.8, those persons shall be liable for any deficiency after disposition of the repossessed or surrendered motor vehicle only if the notice prescribed by this section is given within 60 days of repossession or surrender and does all of the following:

(1) Sets forth that those persons shall have a right to redeem the motor vehicle by paying in full the indebtedness evidenced by the contract until the expiration of 15 days from the date of giving or mailing the notice and provides an itemization of the contract balance and of any delinquency, collection or repossession costs and fees and sets forth the computation or estimate of the amount of any credit for unearned finance charges or canceled insurance as of the date of the notice.

(2) States either that there is a conditional right to reinstate the contract until the expiration of 15 days from the date of giving or mailing the notice and all the conditions precedent thereto or that there is no right of reinstatement and provides a statement of reasons therefor.

(3) States that, upon written request, the seller or holder shall extend for an additional 10 days the redemption period or, if entitled to the conditional right of reinstatement, both the redemption and reinstatement periods. The seller or holder shall provide the proper form for applying for the extensions with the substance of the form being limited to the extension request, spaces for the requesting party to sign and date the form, and instructions that it must be personally served or sent by certified or registered mail, return receipt requested, to a person or office and address designated by the seller or holder and received before the expiration of the initial redemption and reinstatement periods.

(4) Discloses the place at which the motor vehicle will be returned to those persons upon redemption or reinstatement.

(5) Designates the name and address of the person or office to whom payment shall be made.

(6) States the seller's or holder's intent to dispose of the motor vehicle upon the expiration of 15 days from the date of giving or mailing the notice, or if by mail and either the place of deposit in the mail or the place of address is outside of this state, the period shall be 20 days instead of 15 days, and further, that upon written request to extend the redemption period and any applicable reinstatement period for 10 days, the seller or holder shall without further notice extend the period accordingly.

(7) Informs those persons that upon written request, the seller or holder will furnish a written accounting regarding the disposition of the motor vehicle as provided for in subdivision (b). The seller or holder shall advise them that this request must be personally served or sent first-class mail, postage prepaid, or certified mail, return receipt requested, to a person or office and address designated by the seller or holder.

(8) Includes notice, in at least 10-point bold type if the notice is printed, reading as follows: "NOTICE. YOU MAY BE SUBJECT TO SUIT AND LIABILITY IF THE AMOUNT OBTAINED UPON DISPOSITION OF THE VEHICLE IS INSUFFICIENT TO PAY THE CONTRACT BALANCE AND ANY OTHER AMOUNTS DUE."

(9) Informs those persons that upon the disposition of the motor vehicle, they will be liable for the deficiency balance plus interest at the contract rate, or at the legal rate of interest pursuant to Section 3289 if there is no contract rate of interest, from the date of disposition of the motor vehicle to the date of entry of judgment.

The notice prescribed by this section shall not affect the discretion of the court to strike out an unconscionable interest rate in the contract for which the notice is required, nor affect the court in its determination of whether the rate is unconscionable.

(b) Unless automatically provided to the buyer within 45 days after the disposition of the motor vehicle, the seller or holder shall provide to any person liable on the contract within 45 days after their written request, if the request is made within one year after the disposition, a written accounting regarding the disposition. The accounting shall itemize:

(1) The gross proceeds of the disposition.

(2) The reasonable and necessary expenses incurred for retaking, holding, preparing for and conducting the sale and to the extent provided for in the agreement and not prohibited by law, reasonable attorney fees and legal expenses incurred by the seller or holder in retaking the motor vehicle from any person not a party to the contract.

(3) The satisfaction of indebtedness secured by any subordinate lien or encumbrance on the motor vehicle if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the seller or holder, the holder of a subordinate lien or encumbrance must seasonably furnish reasonable proof of its interest, and unless it does so, the seller or holder need not comply with its demand.

(c) In all sales which result in a surplus, the seller or holder shall furnish an accounting as provided in subdivision (b) whether or not requested by the buyer. Any surplus shall be returned to the buyer within 45 days after the sale is conducted.

(d) This section shall not apply to a loan made by a lender licensed under Division 9 (commencing with Section 22000) or Division 10 (commencing with *Section 24000) of the Financial Code.*

HISTORY:

Added Stats 1977 ch 777 § 3, effective September 13, 1977, operative January 1, 1978. Amended Stats 1985 ch 226 § 2; Stats 1987 ch 448 § 4; Stats 1988 ch 1092 § 3; Stats 1996 ch 124 § 9 (AB 3470) (ch 313 prevails), ch 313 § 1 (SB 1639).

NOTES:

Editor's Notes

ADDENDUM TAB O

LEXSTAT CAL CIV CODE § 2983.3

*** THIS DOCUMENT IS CURRENT THROUGH 2009-2010 EXTRAORDINARY SESSIONS 1-5, *** 7, AND 8, AND URGENCY LEGISLATION THROUGH CH 17 OF THE 2010 REGULAR SESSION

CIVIL CODE
Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 14. Lien
Chapter 2b. Automobile Sales Finance Act

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 2983.3 (2009)

§ 2983.3. Acceleration of maturity or repossession of vehicle; Reinstatement of contract

(a) In the absence of default in the performance of any of the buyer's obligations under the contract, the seller or holder may not accelerate the maturity of any part or all of the amount due thereunder or repossess the motor vehicle.

(b) If after default by the buyer, the seller or holder repossesses or voluntarily accepts surrender of the motor vehicle, any person liable on the contract shall have a right to reinstate the contract and the seller or holder shall not accelerate the maturity of any part or all of the contract prior to expiration of the right to reinstate, unless the seller or holder reasonably and in good faith determines that any of the following has occurred:

(1) The buyer or any other person liable on the contract by omission or commission intentionally provided false or misleading information of material importance on his or her credit application.

(2) The buyer, any other person liable on the contract, or any permissive user in possession of the motor vehicle, in order to avoid repossession has concealed the motor vehicle or removed it from the state.

(3) The buyer, any other person liable on the contract, or any permissive user in possession of the motor vehicle, has committed or threatens to commit acts of destruction, or has failed to take care of the motor vehicle in a reasonable manner, so that the motor vehicle has become substantially impaired in value, or the buyer, any other person liable on the contract, or any nonoccasional permissive user in possession of the motor vehicle has failed to take care of the motor vehicle in a reasonable manner, so that the motor vehicle may become substantially impaired in value.

(4) The buyer or any other person liable on the contract has committed, attempted to commit, or threatened to commit criminal acts of violence or bodily harm against an agent, employee, or officer of the seller or holder in connection with the seller's or holder's repossession of or attempt to repossess the motor vehicle.

(5) The buyer has knowingly used the motor vehicle, or has knowingly permitted it to be used, in connection with the commission of a criminal offense, other than an infraction, as a consequence of which the motor vehicle has been seized by a federal, state, or local agency or authority pursuant to federal, state, or local law.

(6) The motor vehicle has been seized by a federal, state, or local public agency or authority pursuant to (A) Section 1324 of Title 8 of the United States Code or Part 274 of Title 8 of the Code of Federal Regulations, (B) Section 881 of Title 21 of the United States Code or Part 9 of Title 28 of the Code of Federal Regulations, or (C) other federal, state, or local law, including regulations, and, pursuant to that other law, the seizing authority, as a precondition to the return of the motor vehicle to the seller or holder, prohibits the return of the motor vehicle to the buyer or other person liable on the contract or any third person claiming the motor vehicle by or through them or otherwise effects or requires the termination of the property rights in the motor vehicle of the buyer or other person liable on the contract or claimants by or through them.

(c) Exercise of the right to reinstate the contract shall be limited to once in any 12-month period and twice during the term of the contract.

(d) The provisions of this subdivision cover the method by which a contract shall be reinstated with respect to curing events of default which were a ground for repossession or occurred subsequent to repossession:

(1) Where the default is the result of the buyer's failure to make any payment due under the contract, the buyer or any other person liable on the contract shall make the defaulted payments and pay any applicable delinquency charges.

(2) Where the default is the result of the buyer's failure to keep and maintain the motor vehicle free from all encumbrances and liens of every kind, the buyer or any other person liable on the contract shall either satisfy all encumbrances and liens or, in the event the seller or holder satisfies the encumbrances and liens, the buyer or any other person liable on the contract shall reimburse the seller or holder for all reasonable costs and expenses incurred therefor.

(3) Where the default is the result of the buyer's failure to keep and maintain insurance on the motor vehicle, the buyer or any other person liable on the contract shall either obtain the insurance or, in the event the seller or holder has obtained the insurance, the buyer or any other person liable on the contract shall reimburse the seller or holder for premiums paid and all reasonable costs and expenses, including, but not limited to, any finance charge in connection with the premiums permitted by Section 2982.8, incurred therefor.

(4) Where the default is the result of the buyer's failure to perform any other obligation under the contract, unless the seller or holder has made a good faith determination that the default is so substantial as to be incurable, the buyer or any other person liable on the contract shall either cure the default or, if the seller or holder has performed the obligation, reimburse the seller or holder for all reasonable costs and expenses incurred in connection therewith.

(5) Additionally, the buyer or any other person liable on the contract shall, in all cases, reimburse the seller or holder for all reasonable and necessary collection and repossession costs and fees incurred, including attorney's fees and legal expenses expended in retaking and holding the vehicle.

(e) If the seller or holder denies the right to reinstatement under subdivision (b) or paragraph (4) of subdivision (d), the seller or holder shall have the burden of proof that the denial was justified in that it was reasonable and made in good faith. If the seller or holder fails to sustain the burden of proof, the seller or holder shall not be entitled to a deficiency, but it shall not be presumed that the buyer is entitled to damages by reason of the failure of the seller or holder to sustain the burden of proof.

(f) This section shall not apply to a loan made by a lender licensed under Division 9 (commencing with Section 22000) or Division 10 (commencing with *Section 24000) of the Financial Code.*

HISTORY:

Added Stats 1961 ch 1626 § 4 p 3539, effective January 1, 1962. Amended Stats 1976 ch 1265 § 4; Stats 1985 ch 226 § 3; Stats 1986 ch 1236 § 1. Amended Stats 1987 ch 448 § 5.

NOTES:

Editor's Notes

Divisions 9 and 10 of the Financial Code, referred to in subdivision (f) of this section, were repealed by Stats 1994, ch 1115. For similar provisions, see current Division 9, "California Finance Lenders Law," commencing with *Fin C § 22000*.

ADDENDUM TAB P

LEXSTAT CAL CIV CODE § 2983.8

*** THIS DOCUMENT IS CURRENT THROUGH 2009-2010 EXTRAORDINARY SESSIONS 1-5, *** 7, AND 8, AND URGENCY LEGISLATION THROUGH CH 17 OF THE 2010 REGULAR SESSION

CIVIL CODE
Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 14. Lien
Chapter 2b. Automobile Sales Finance Act

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 2983.8 (2010)

§ 2983.8. Prohibition of deficiency judgment after sale of mobilehome or sale or other disposition of motor vehicle

Notwithstanding Section 2983.2 or any other provision of law, no deficiency judgment shall lie in any event in any of the following instances:

(a) After any sale of any mobilehome for which a permit is required pursuant to *Section 35780 or 35790 of the Vehicle Code* for failure of the purchaser to complete his or her conditional sale contract given to the seller to secure payment of the balance of the purchase price of such mobilehome. The provisions of this subdivision shall not apply in the event there is substantial damage to the mobilehome other than wear and tear from normal usage. This subdivision shall apply only to contracts entered into on or after the effective date of the act that enacted this subdivision and before July 1, 1981.

(b) After any sale or other disposition of a motor vehicle unless the court has determined that the sale or other disposition was in conformity with the provisions of this chapter and the relevant provisions of Division 9 (commencing with *Section 9101) of the Commercial Code*, including Sections 9610, 9611, 9612, 9613, 9614, 9615, and 9626. The determination may be made upon an affidavit unless the court requires a hearing in the particular case.

HISTORY:

Added Stats 1972 ch 1001 § 3. Amended Stats 1980 ch 1149 § 10; Stats 1984 ch 1376 § 1; Stats 1999 ch 991 § 8 (SB 45), operative July 1, 2001.

NOTES:

Amendments:

1980 Amendment:

ADDENDUM TAB Q

LEXSTAT CAL COM CODE SEC 9201

DEERING'S CALIFORNIA CODES ANNOTATED

*** THIS DOCUMENT IS CURRENT THROUGH 2009-2010 EXTRAORDINARY SESSIONS 1-5, *** 7, AND 8, AND URGENCY LEGISLATION THROUGH CH 17 OF THE 2010 REGULAR SESSION

UNIFORM COMMERCIAL CODE
Division 9. Secured Transactions
Chapter 2. Effectiveness of Security Agreement: Attachment of Security Interest: Rights of Parties to Security Agreement

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal U Com Code § 9201 (2009)

§ 9201. Effectiveness of security agreement in general; Applicability of other laws; Conflict of law

(a) Except as otherwise provided in this code, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(b) A transaction subject to this division is subject to any applicable rule of law which establishes a different rule for consumers; to Chapter 5 (commencing with *Section 17200) of Part 2 of Division 7 of the Business and Professions Code*; Chapter 1 (commencing with *Section 17500) of Part 3 of Division 7 of the Business and Professions Code*; the Retail Installment Sales Act, Chapter 1 (commencing with *Section 1801) of Title 2 of Part 4 of Division 3 of the Civil Code*; the Automobile Sales Finance Act, Chapter 2b (commencing with *Section 2981) of Title 14 of Part 4 of Division 3 of the Civil Code*; Part 4 (commencing with *Section 1738) of Division 3 of the Civil Code*, with respect to the applicable provisions of Titles 1 (commencing with Section 1738), 1.3 (commencing with Section 1747), 1.3A (commencing with Section 1748.10), 1.3B (commencing with Section 1748.20), 1.4 (commencing with Section 1749), 1.5 (commencing with Section 1750), 1.6 (commencing with Section 1785.1), 1.61 (commencing with Section 1785.41), 1.6A (commencing with Section 1786), 1.6B (commencing with Section 1787.1), 1.6C (commencing with Section 1788), 1.6D (commencing with Section 1789), 1.6E (commencing with Section 1789.10), 1.6F (commencing with Section 1789.30), 1.7 (commencing with Section 1790), 1.8 (commencing with Section 1798), 1.83 (commencing with Section 1799.5), 1.84 (commencing with Section 1799.8), 1.85 (commencing with Section 1799.90), 1.86 (commencing with Section 1799.200), 2 (commencing with Section 1801), 2.4 (commencing with Section 1812.50), 2.5 (commencing with Section 1812.80), 2.6 (commencing with Section 1812.100), 2.7 (commencing with Section 1812.200), 2.8 (commencing with Section 1812.300), 2.9 (commencing with Section 1812.400), 2.95 (commencing with Section 1812.600), 2.96 (commencing with Section 1812.620), 3 (commencing with Section 1813), 4 (commencing with Section 1884), and 14 (commencing with Section 2872); the Industrial Loan Law, Division 7 (commencing with *Section 18000) of the Financial Code*; the Pawnbroker Law, Division 8 (commencing with *Section 21000) of the Financial Code*; the California Finance Lenders Law, Division 9 (commencing with *Section 22000) of the Financial Code*; and the Mobilehomes-Manufactured Housing Act of 1980, Part 2 (commencing with *Section 18000) of Division 13 of the Health and Safety Code*; and to any applicable consumer protection statute, regulation, or law.

(c) In case of conflict between this division and a rule of law, statute, or regulation described in subdivision (b), the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subdivision (b) has only the effect the statute or regulation specifies.

(d) This division does not do either of the following:

(1) Validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subdivision (b).

(2) Extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it.

HISTORY:

Added Stats 1999 ch 991 § 35 (SB 45), operative July 1, 2001.

NOTES:

Former Sections:

Former § 9201, similar to the present section, was enacted Stats 1963 ch 819, effective January 1, 1965, and repealed Stats 1999 ch 991 § 34, operative July 1, 2001.

Historical Derivation:

(a) Former UCC § 8321, as added Stats 1984 ch 927 § 6, amended Stats 1986 ch 766 § 3.

(b) Former UCC § 9201, as enacted Stats 1963 ch 819.

(c) Former UCC § 9203, as enacted Stats 1963 ch 819, amended Stats 1974 ch 997 § 16, Stats 1981 ch 724 § 5, Stats 1982 ch 1082 § 4, Stats 1983 ch 1124 § 13, Stats 1984 ch 927 § 9, Stats 1994 ch 668 § 11, Stats 1996 ch 497 § 15.

(d) Former CC § 2988, as enacted 1872, amended Stats 1935 ch 716 § 2.

(e) Former CC § 3014, as added Stats 1935 ch 716 § 1, amended Stats 1939 ch 1022 § 1, Stats 1955 ch 292 § 2.

(f) Former CC § 3015, as added Stats 1935 ch 716 § 1.

(g) Former CC § 3016.1, as added Stats 1935 ch 716 § 1, amended Stats 1939 ch 1022, Stats 1st Ex Sess 1940 ch 48, Stats 1st Ex Sess 1946 ch 130, Stats 1953 ch 483, Stats 1955 ch 292, Stats 1961 ch 549.

Official Comments on Uniform Commercial Code:

1. **Source.** Former Sections 9-201, 9-203(4).

2. **Effectiveness of Security Agreement.** Subsection (a) provides that a security agreement is generally effective. With certain exceptions, a security agreement is effective between the debtor and secured party and is likewise effective against third parties. Note that "security agreement" is used here (and elsewhere in this Article) as it is defined in Section 9-102: "an agreement that creates or provides for a security interest." It follows that subsection (a) does not provide that every term or provision contained in a record that contains a security agreement or that is so labeled is effective. Properly read, former Section 9-201 was to the same effect. Exceptions to the general rule of subsection (a) arise where there is an overriding provision in this Article or any other Article of the UCC. For example, Section 9-317 subordinates unperfected security interests to lien creditors and certain buyers, and several provisions in Part 3 subordinate some security interests to other security interests and interests of purchasers.

3. **Law, Statutes, and Regulations Applicable to Certain Transactions.** Subsection (b) makes clear that certain transactions, although subject to this Article, also are subject to other applicable laws relating to consumers or specified in that subsection. Subsection (c) provides that the other law is controlling in the event of a conflict, and that a violation of other law does not *ipso facto* constitute a violation of this Article. Subsection (d) provides that this Article does not validate violations under or extend the application of the other applicable laws.

ADDENDUM TAB R

OCC Inter. Ltr. 416, Fed. Banking L. Rep. P 85,640, 1988 WL 284802 (O.C.C.)

Office of the Comptroller of the Currency (O.C.C.)

OCC Interpretive Letter
Banking Research Digest (c) BRG, Inc.

Interpretive Letter No.
416

February 16,
1988

BRD SECTION:

Section 720A / File 4
TOPIC:

General Powers:
Discounting and Negotiating Notes, Drafts, Etc.
LAWS:

12 U.S.C. Section 24(7)
BRG DIGEST:

Express power to discount evidences of debt permits national bank to sell non-mortgage consumer loans to operating subsidiary, which will resell them to third-party trust for securitization. (OCC Interpretive Letter No. 416.)

Mr. Timothy A.G. Gerhold
Assistant General Counsel

Dear Mr. Gerhold:

This is in response to your letter of April 8, 1987, and a follow-up letter dated June 22, 1987, providing notification of intent to establish a new operating subsidiary of First National Bank of Boston ("the Bank"), as required by the Office's regulation at 12 C.F.R. § 5.34. BancBoston Receivables, Inc. ("the Subsidiary") will engage in the general business of purchasing loan assets from the Bank and selling them to an independent third party. For the reasons set forth below, it is my opinion that the Subsidiary's intended activities are permissible and that the Bank may therefore go forward with its proposal.

According to the information provided in your letter, the Subsidiary will from time to time purchase from the Bank loans, leases, installment sales contracts, and various other types of loan assets. It will sell these assets, or participations in them, to unaffiliated third parties. These parties in turn will issue bonds, certificates, or other securities evidencing ownership interests in, or collateralized by, the loan assets. Neither the Bank nor the Subsidiary will underwrite or deal in the bonds, certificates, or securities payable from or collateralized by the loan assets. The Bank or the Subsidiary will enter into servicing agreements with respect to the sold loan assets, obtain letters of credit or other forms of credit support from unaffiliated institutions, and generally take such other actions as may be necessary or incidental to the accomplishment of the foregoing.

As further indicated in your letter, a specific example of the type of transaction contemplated would be the following. The Bank has a dealer paper program in which selected automobile dealers in the Bank's area originate motor vehicle retail installment sales contracts in accordance with the Bank's current credit standards. The Bank purchases contracts from dealers after a credit review by Bank personnel. It is planned that the Subsidiary would purchase the contracts from the Bank and sell them to an unaffiliated special purpose trust ("the Trust"). The Trust in turn would issue and sell, through a public offering underwritten by an investment bank, fixed-rate certificates evidencing undivided fractional interests in the pool of contracts held by the Trust. The certificates would be payable from the collections on the contracts and from any necessary drawings on a letter of credit issued by an unaffiliated bank that guarantees the Trust against loss on an as yet undertermined percentage of the pool of contracts held by the Trust. Neither the Trust nor the holders of the certificates would have recourse to the Bank or the Subsidiary except for breach of the representations made in connection with the sale of the contracts. Aside from that, the certificate holders would look only to the proceeds from the contracts and the letter of credit for payment, and the letter of credit bank would have recourse only to amounts deposited in a special reserve fund which would result from the difference between the rate of interest payable to the certificate holders and the rate of interest payable on the contracts. The Bank would continue to service the contracts for the Trust under a servicing agreement and would receive a servicing fee. The Bank would also retain the right to receive the excess in the fund over what is required to satisfy the letter of credit bank.

Since its enactment, the National Bank Act of 1864 has authorized national banks to "carry on the business of banking; by discounting and negotiating promissory notes, ... and other evidences of debt...." 12 U.S.C. § 24 (Seventh). The term "negotiating" authorizes a bank's transfer of its notes or other evidences of debt acquired in the course of the banking business. See Danforth v. National State Bank, 48 F. 271 (3d Cir.1891); First National Bank of Salem v. Elmer, 278 S.W. 826 (Mo.App.1926). The Supreme Court has long recognized that the negotiation of evidences of debt acquired through a national bank's express authority to lend money on the security of real estate is authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). First National Bank of Hartford v. City of Hartford, 273 U.S. 548 (1927). Since national banks are also expressly authorized by the same statute to make loans on personal security, that reasoning is equally applicable here. The sale by a national bank of loan assets through its operating subsidiary to a trustee constitutes the negotiation of evidences of debt as expressly authorized by 12 U.S.C. § 24 (Seventh).

In addition to the express power to negotiate evidences of debt, the National Bank Act also gives national banks "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 (Seventh). A variety of tests for incidental powers has been propounded by the courts over the years, but even the most restrictive test-that enunciated by the First Circuit in the Arnold Tours case-permits the sale of loan assets in the proposed manner. In Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir.1972), the court found that an activity qualifies as an incidental power if it is "convenient or useful" to an expressly authorized banking power. The sale of loan assets to a trustee, who will subsequently issue pass-through certificates representing ownership interests in such assets, can be "convenient or useful" to a bank's express power to loan money on personal security. Such sales provide liquidity and enable the Bank to fund new loans.

In a more general sense, the ability to sell bank assets acquired in its ordinary course of business is certainly "necessary to carry on the business of banking." The unrestricted ownership of property connotes the ability to transfer that property by sale or otherwise, and sound management practice may require that banks sell or transfer their assets as business conditions warrant. See letter of Emory W. Rushton, Deputy Comptroller for Multinational Banking, [Current Developments] Fed.Banking L.Rep. (CCH) ¶ 85,602 (March 24, 1987).

Nor is the sale of Bank loan assets prohibited by the Glass-Steagall Act. Section 16 of the Act, 12 U.S.C. § 24 (Seventh), limits the extent to which national banks can deal in and underwrite securities. The Bank's program will not be affected by this provision because the pass-through certificates or other securities will be issued and underwritten by a third party, not by the Bank or its Subsidiary. The Bank and the Subsidiary also will not be dealing in the instruments in the secondary market. Simply stated, neither one will engage in any securities activity within the purview of the Glass-Steagall Act.

It is my opinion that the recently enacted moratorium on the Office's approval of certain bank securities activities is not applicable to your proposal. Section 201(b) of the Competitive Equality Banking Act of 1987, Pub.L. No. 100-86, 100 Stat. 552, provides in relevant part:

> (2) A Federal banking agency may not authorize or allow by action, inaction, or otherwise ... any insured bank or subsidiary or affiliate thereof to engage in the United States to any extent whatever-
>
> > (B) in any securities activity not legally authorized in writing prior to March 5, 1987....

The Bank and its Subsidiary will not be engaging in any “securities activity” under your proposal. As outlined above their activity will be limited to the purchase and sale of loan assets, a traditional banking function expressly authorized by the National Bank Act, 12 U.S.C. § 24 (Seventh).

In sum, the Bank's program is fully consistent with the national banking laws and the precedents of this Office and is not prohibited by the Glass-Steagall Act. This conclusion is based upon the activities described in your letters of April 8 and June 22, 1987, and telephone conversations with members of your staff. Any material change in the program as you have described it might require a different conclusion, and I understand that you will file an appropriate notification if you desire additional authority for the Subsidiary to engage in additional activities in the future.

Sincerely,
J. Michael Shepherd
Senior Deputy Comptroller for Corporate and Economic Programs

OCC Inter. Ltr. 416, Fed. Banking L. Rep. P 85,640, 1988 WL 284802 (O.C.C.)
END OF DOCUMENT

ADDENDUM TAB S

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1005
September 2004

June 10, 2004

Fred H. Miller
President
National Conference of Commissioners on Uniform State Laws
211 E. Ontario Street, Suite 1300
Chicago, IL 60611

Lance Liebman
Director
American Law Institute
Executive Office
Philadelphia, PA 19104

Dear Messrs. Miller and Liebman:

I am writing in response to your letter of May 12, 2004, concerning the impact of recently adopted OCC regulations concerning preemption of state laws [1] on provisions of the Uniform Commercial Code (UCC), which has been sponsored by NCCUSL and the ALI.[2] There has been some misunderstanding of the scope of the rules, and I welcome the opportunity to address your questions.

First, the rule only preempts the types and features of state laws pertaining to making loans and taking deposits that are specifically listed in the regulation. These are state laws for which substantial precedent existed, prior to our adoption of the preemption rules, recognizing the interference they pose to the ability of Federally chartered institutions to operate under uniform Federal standards. The rule does not operate to preempt other types of State laws – laws that do not appear on the lists in the regulation. Second, for all other types of laws, the OCC may determine, on a case-by-case basis, in the same manner and employing the same judicially-recognized standards of preemption that we applied to preemption issues prior to adoption of these regulations, whether such non-listed state laws are preempted under such standards, which are summarized by the "obstruct, impair, or condition" phrasing used in the rule. Finally, again

---

[1] 69 Fed. Reg. 1904 (January 13, 2004) (the preemption rule) (adding new §§ 7.4007 (deposit taking), 7.4008 (non-real estate lending), and 7.4009 (other Federally authorized activities of national banks) and revising § 34.4 (real estate lending)).

[2] Your letter asks us to address the UCC sponsored by NCCUSL and the ALI, which has been the law in every state for some 50 years. We are not undertaking to address non-uniform provisions that individual states may adopt and elect to include in the body of their state commercial code.

with respect to deposit taking and lending, the rule lists types of state laws that generally *do apply* to national banks and provides, further, that state laws in addition to those listed also apply if the OCC determines that they only incidentally affect a national bank's exercise of its Federal powers or are "otherwise consistent" with those powers. In the preamble to the final rule, we explained that state laws that "establish the legal infrastructure that makes practicable the conduct of [the banking] business"[3] would not be preempted.

You have described the UCC as providing "the basic legal infrastructure for sales and leases of goods, negotiable instruments and bank deposits and check collection, commercial funds transfers, letters of credit, documents of title, investment securities and personal property secured transactions, including loans." You have asked us to confirm your conclusion that:

> the UCC is a body of state law that does not obstruct, impair, or condition the ability of national banks to exercise fully the powers granted by federal law. Rather those powers are implemented and supported by the UCC, which provides a uniform law of general applicability on which parties rely in their daily commercial transactions.

We agree. Accordingly, such provisions would not be preempted under the OCC's preemption rules nor under the judicially-developed standards of preemption that would be applicable to the preemption analysis of laws not specifically listed in our regulations.

I hope this letter is responsive to your concerns.

Sincerely,

/s/ *Julie L. Williams*

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[3] 69 Fed. Reg. at 1913.

ADDENDUM TAB T

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1095
March 2008
12 CFR 37

February 27, 2008

Mr. Paul D. Egide
Director
State of Wisconsin
Department of Financial Institutions
PO Box 8041
Madison, Wisconsin 53708-8041

Dear Mr. Egide:

I am writing in response to two questions you posed concerning the OCC's regulation governing debt cancellation contracts, 12 C.F.R. part 37. I apologize for the delay in this reply. In brief, your questions and our answers are as follows:

1. If a bank offers a debt cancellation contract (DCC) on a closed-end loan that is repayable in 5 years, and the DCC provides protection for the full 5-year loan term, can the bank collect the full cost of the DCC in monthly periodic payments over the first year of the loan?

No. For the reasons discussed below, where a national bank's DCC provides protection on a closed-end loan repayable in 5 years, the bank cannot collect the full cost of the DCC in monthly periodic payments over the first year of the loan. To comply with the periodic payment option under section 37.5, the bank must collect DCC fees in periodic payments (i) over the full 5-year term of the loan, or (ii) until such time as the loan is repaid.

2. Can an automobile dealer sell a national bank's DCC, as the bank's agent, in connection with the dealer's automobile retail installment sales contract that the dealer will assign to the bank, and does the OCC's DCC regulation apply to this transaction?

Yes. For the reasons discussed below, a national bank is authorized to offer DCCs to consumers through automobile dealers by 12 U.S.C. 24(Seventh) and 12 C.F.R. part 37, and the DCCs are subject to the standards of part 37 as well.

1. Payment of the DCC Fee

Section 37.5 of the DCC rule (Method of payment of fees) provides, in relevant part:

> A bank may offer a customer the option of paying the fee for a contract in a single payment, provided the bank also offers the customer a *bona fide* option of paying the fee for that contract in monthly or other periodic payments.[1]

Section 37.5 permits the bank to offer a customer the option of paying a monthly or other periodic payment for a DCC. The language of the regulation and its preamble establish that the periodic payment must continue over the loan term or until the loan is paid. Section 37.5 requires a *bona fide* alternative to paying for the DCC in a single payment. The preamble explains that the periodic payment is intended to operate on a "pay as you go" basis so that customers would not be induced to pay "up front" for coverage they never receive because the loan is prepaid.[2] The reference to "pay as you go" means the bank must permit the customer to pay for the DCC in periodic payments over the term of the customer's loan. Otherwise, if the bank could collect the full DCC fee over a period that is shorter than the loan term, the bank could collect payment "up front" for coverage that the customer may never receive if the loan is prepaid. The OCC expressly intended to mitigate this possibility, as explained in the preamble to the regulation.

Accordingly, where a national bank's DCC provides protection on a closed-end loan repayable in 5 years, the bank cannot collect the full cost of the DCC in monthly periodic payments over the first year of the loan. To comply with the periodic payment option under section 37.5, the bank must collect DCC fees in periodic payments (i) over the full 5-year term of the loan, or (ii) until such time as the loan is repaid.

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[1] The OCC states in the preamble to the final rule adopting section 37.5 that, "The option [of paying the fee in periodic payments] is '*bona fide*' if it is not deliberately priced in such a way as to deter a customer from selecting that option." *See* 67 FR 58962, 58967 (September 19, 2002).

[2] The OCC states as follows in the preamble to the regulation:

> We continue to believe that the approach that best balances encouraging banks to provide a viable choice of products for consumers with discouraging unfair practices is to require banks to offer both options [(*i.e.,* a no-refund DCC or a refundable DCC)] so that a customer can choose between a lower total fee or the availability of a refund. In our view, the potential for unfairness in a no-refund product lies principally in the fact that the customer may be induced to pay "up front" for coverage that he or she never receives because the loan is prepaid. This result is substantially mitigated if the consumer has the option of DCC…coverage on a "pay as you go" basis.

67 FR 58962, 58967 (September 19, 2002).

2. Sale of DCCs Through Automobile Dealers

In your letter, you also inquire about the applicability of 12 C.F.R. part 37 to DCCs offered on retail installments sales contracts (RICs) originated by automobile dealers and assigned to national banks.

We recently addressed this issue in an OCC interpretive letter.[3] As we explained in that letter, part 37 provides that a "national bank is authorized to enter into debt cancellation contracts and debt suspension agreements and charge a fee therefor, in connection with extensions of credit it makes, pursuant to 12 U.S.C. 24(Seventh)."[4] Section 24(Seventh) authorizes a national bank to engage in activities that are part of, or incidental to, the business of banking as well as to engage in certain specified activities listed in the statute. "Negotiating promissory notes" and "loaning money on personal security" are activities specified in section 24(Seventh).

Pursuant to part 37, national banks are authorized to enter into DCCs with respect to loans they purchase as well as loans they originate directly. The OCC has previously indicated that a national bank-owned RIC is the equivalent of a national bank loan.[5] Once purchased, a RIC is treated for regulatory and reporting purposes the same as a loan originated by the bank.[6] Therefore, the purchase of a RIC is a permissible exercise of a national bank's lending powers under section 24(Seventh) and thus constitutes an extension of credit on which a national bank may offer a DCC under part 37.

In addition, a national bank may offer and sell DCCs through an agent. Section 24(Seventh) states expressly that a national bank may use "duly authorized officers or agents" to exercise its incidental powers.[7] Thus, national banks are authorized by federal law to offer, through agents, DCCs on RICs that the bank purchases. Whether a particular third party – such as an auto dealer – is acting as agent for a national bank with respect to the sale of a DCC depends on the terms of the arrangement between the third party and the bank and the circumstances under which the DCC is offered. For example, an auto dealer that offers a DCC provided by a national bank to a customer whose RIC the bank has determined to purchase could, depending on the circumstances,

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[3] *See* OCC Interpretive Letter No. 1093 (Oct. 29, 2007).

[4] 12 C.F.R. 37.1(a).

[5] *See* OCC Interpretive Letter No. 416 (Feb. 16, 1988) (referring to motor vehicle retail installment sales contracts as "loan assets"); *see also* OCC Interpretive Letter No. 585 (June 8, 1992) (stating that the securitization of installment sales paper is a permissible method for a national bank to sell its "loans").

[6] The Federal Financial Institutions Examination Council's call report instructions treat the purchase of retail installment sales paper as a loan. FFEIC Form No. 031 and 041, item number 6.c. In addition, the discount of installment consumer paper is a loan for purposes of the OCC's lending limit rules. 12 C.F.R. §§ 32.2(k) and 32.3(b)(2).

[7] 12 U.S.C. 24(Seventh); *see also* 12 C.F.R. § 7.1004; and *SPGGC v. Ayotte*, 488 F.3d 525, 532 (May 30, 2007) ("Accordingly, we agree . . . that the National Bank Act authorizes national banks to engage agents to carry out some of their activities.")

be acting as agent for that bank with respect to the offer and sale of the DCC. In such a case, the fact that the dealer originated the RIC in the dealer's own name would not necessarily mean that the dealer could not act as the bank's agent with respect to the DCC.

I trust this has been responsive to your inquiry.

Sincerely,

- signed -

Julie L. Williams
First Senior Deputy Comptroller
and Chief Counsel