Comments of the
National Consumer Law Center
On behalf of its
Low Income Clients

Regarding

Interstate Banking; Federal Interest Rate Authority:
Proposed Rulemaking

Federal Deposit Insurance Corporation

December 13, 2005

These comments are submitted by the National Consumer Law Center[1] on behalf of its low income clients. We appreciate the opportunity provided by the FDIC to comment on the proposed regulations implementing Sections 24(j) and 27 of the Federal Deposit Insurance Act (FDIA).[2]

We are concerned about whether the proposed regulations are necessary, finely tuned, and whether they will unleash unintended consequences that will harm consumers. Regarding these issues, NCLC endorses the Comments filed by the Center for Responsible Lending (CRL) filed on this date. We request the FDIC to read our comments in tandem with CRL's as we believe they are complementary.

In these comments, NCLC's goal is to ensure that final regulations contain an accurate expression of the limited authority that insured state chartered banks[3] possess under *federal* law to preempt state law, *if* the FDIC proceeds to finalize them. The proposed regulations do express the FDIC's attempt to remain true to the legal constraints

[1]The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, (5th ed. 2003) and Cost of Credit: Regulation, Preemption, and Industry Abuses (3d ed. 2005) and Repossessions and Foreclosures (5th ed. 2002) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC=s attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by Elizabeth Renuart.

[2] These provisions are codified as 12 U.S.C. §§ 1831a(j) and 1831d, respectively. The proposed regulations were published at 70 Fed. Reg. 60019 (Oct. 14, 2005).
[3] The phrase "insured state chartered bank" will hereinafter be referred to as "state bank."

under which it operates. However, the agency strays from its legal grounding regarding three issues: the application of interest rate preemption and exportation to state bank operating subsidiaries; the definition of "activity conducted at a branch" for interstate branch preemption purposes; and the effect of state overrides of section 1831d. Another concern addressed in these comments is the disclosure to consumers regarding applicable state law.

First, these comments provide an overview of the scope of state bank powers and preemption, the role of the FDIC in regulating state banks, and the need for clarity and consistency when describing the limitations to preemption rights. Next, the comments address the areas where we believe the FDIC has exceeded its authority in codifying interest rate and interstate branching preemption. Finally, the comments provide a suggested disclosure for consumers regarding applicable law.

I. Introduction

State banks are created by and operate primarily under the laws of their home state, with some exceptions. These banking powers are enumerated in state law and most state banking codes also include some type of "incidental" power provision.[4] An incidental power provision expands upon the enumerated powers by permitting banks to engage in activities that are related to the express powers.[5] Further, some states grant their banks the ability to engage in the same activities permissible for national banks, through state "parity" or "wild card" acts.[6] The primary regulator of state-chartered banks is the state bank supervisor.

A *federa*l regulatory overlay exists due to the federal insurance that state banks typically purchase. The FDIC retains certain federal authority over insured state-chartered banks that are not members of the Federal Reserve System and regularly examines these institutions.[7] The FDIC's oversight centers upon safety and soundness concerns, bank conversions, the insurance fund and its solvency, and other administrative matters.[8]

In 1980, Congress created parity between federally insured state-chartered banks (including state savings banks) and national banks in one area. Congress extended the

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[4] John J. Schroeder, *"Duel" Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 Ind. L. Rev. 197, 202 (2003).
[5] Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers,* 26 Loy. U. Chi. L.J. 351, 356 (1995).
[6] *Id.* at 206. Under state parity acts, state-chartered banks may be allowed to operate as national bank "copycats," in their home state. However, states cannot confer exportation rights beyond their borders.
[7] 12 U.S.C. § 1820(b)(2); § 521 of Pub. L. No. 96-221, tit. v, 94 Stat. 164 (1980).
[8] *See, e.g.,* 12 U.S.C. §§ 1814 (continuation of insurance), 1815 and 1816 (insurance), 1817 (reporting requirements and assessments), 1818 (termination of insurance), 1819 (powers of the FDIC), 1820 (examinations), 1821, 1821a, 1823 (relating to the insurance fund), 1822 (FDIC as a receiver), 1824 (borrowing authority of the FDIC), 1825 (issuance of notes, debentures, etc. by the FDIC), 1827 (annual reports by the FDIC).

most favored lender status granted to national banks under section 85 of the National Bank Act (NBA) to these state institutions.[9]

As a result of receiving the mantle of the most favored lender, a federally insured state-chartered financial institution may charge the greater of: (1) one percent above the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the district in which such state bank is located; or (2) the rate allowed by the laws of the state in which the state bank is located.[10]

The FDIC has issued several letters over the years in which it opines that section 521 of DIDA should be interpreted in the same manner as section 85 of the National Bank Act. For example, the agency defines "interest" in the same manner as does the Office of the Comptroller of the Currency for national banks.[11] The FDIC interprets the scope of section 521 to include the preemption of common law usury rate restrictions in addition to the preemption of statutory and constitutional restrictions.[12] Finally, the FDIC adopted OCC Letter No. 822, defining the "location" of the bank for exportation purposes.[13]

Beyond most favored lender interest rate preemption and the exportation rights that accompany it, the ability of federally insured state-chartered banks to preempt other aspects of their home or host state law is limited. As noted above, state-chartered banks are first and foremost creatures of *state* law.[14] The instances where *federal* law creates preemption rights related to consumer transactions are few in number and limited in scope.

Of relevance to this discussion, Congress expanded the ability of state-chartered banks to preempt state laws when the bank branches into another state. The Interstate Banking and Branching Efficiency Act of 1994, as amended in 1997 (also known as the Riegle-Neal Act) provides that the laws of the host state applies to branches of state-chartered banks to the extent those state laws apply to national bank branches.[15]

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[9] Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA), *amending*, 12 U.S.C. § 1831d(a)(state-chartered banks); 12 U.S.C. §§ 1463(g)(state savings banks); 1831(b)(definition of state savings association as including savings banks). At that time, Congress also granted federally insured or chartered savings associations and federally insured credit unions most favored lender status.

[10] 12 U.S.C. § 1831d(a).

[11] FDIC General Counsel Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17, 1998); FDIC Letter (July 8, 1992); FDIC Letter (Oct. 20, 1983). *See also* Harris v. Chase Manhattan Bank, N.A., 35 Cal. Rptr. 2d 733 (Cal. Ct. App. 1994).

[12] FDIC Letter (July 12, 1992).

[13] FDIC General Counsel Opinion No. 11, 63 Fed. Reg. 27282 (May 18, 1998).

[14] Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 Loy. U. Chi. L.J. 351, 358 (1995).

[15] 12 U.S.C. § 1831a(j).

If the host state law does not apply to the activities of the branch, then the bank's home state law applies.[16] The preemption of state law permitted under this Act does not apply outside of the interstate branching context and does not apply to activities not performed by the branch itself. Further, Congress did not intend to weaken the authority of states to protect the interests of consumers.[17]

In promulgating any final version, we urge the FDIC to carefully craft language to ensure that these lines are more clearly delineated. An example of where the FDIC overstated the scope of the Riegle-Neal Act includes the following: "Statements by other so-sponsors reinforce the statements of Representatives Roukema and Vento that Riegle-Neal II was intended to provide parity between state banks and national banks with regard to *interstate activities*." The FDIC should have said "with regard to *interstate activities of bank branches*."[18] Tying the activities to the branch is critical since the scope of the Riegle-Neal Act is limited in this way. The agency did made this connection in other sections of the explanatory material on the same page as the above quote. We urge the FDIC to be consistent. Parity with national banks with regard to interstate activities is very different from parity with national banks with regard to interstate activities of bank branches.

II. State Bank Operating Subsidiaries, Agents of the Banks, or Other Third Parties Are NOT Entitled to Interest Rate Preemption

With no supporting analysis, the FDIC states that state bank subsidiaries can utilize the section 27 most favored lender doctrine to the same extent that national bank operating subsidiaries may under section 85 of the NBA. This pronouncement appears only in the Supplementary Information.[19] The only justification for this statement is to provide "parity." However, the FDIC does not have the authority to provide parity for insured state chartered banks with national banks in *all* respects, as discussed below.

First, the OCC's extension of preemption rights to national bank operating subsidiaries is highly controversial.[20] In 2001, the OCC conferred national bank preemption rights upon national bank subsidiaries.[21] Nowhere has Congress explicitly addressed the extension of national bank preemption to operating subsidiaries. The

[16] *Id.*
[17] H.R. Conf. Rep. No. 103-651 at 53 (1994), reprinted in 1994 U.S.C.C.A.N. 2074.
[18] 70 Fed. Reg. 60019, 60024 (Oct. 14, 2005) (emphasis added).
[19] 70 Fed. Reg. at 60027.
[20] Commenters to the OCC's proposed rule expressed concern that granting preemption rights to subsidiaries prevents states from regulating these companies as they traditionally have under licensing, corporate governance, and consumer protection laws. 66 Fed. Reg. 34784, 34788 (July 2, 2001). Since then two law professors were unable to justify the OCC's action under principles of federal banking law. Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System*, 23 Ann. Rev. Banking & Fin. L. 225 (2004)(an excellent dissection of the National Bank Act and the lack of authority therein to extend preemption rights to operating subsidiaries); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effects on Predatory Lending Regulations*, 88 Minn. L. Rev. 518, 581/-/583, 621, 622 (2004) (discussing the phenomena of renting charters and co-branded credit cards; concluding that applying the exportation doctrine to non-bank lenders is not justified under principles of banking law).
[21] 12 C.F.R. § 7.4006; 66 Fed. Reg. 34,784, 34,788-789 (July 2, 2001).

Comptroller did not argue this point in the Supplementary Information accompanying the regulation expanding preemption to these entities.[22] Instead, he relied upon the OCC's longstanding approval of banks owning operating subsidiaries, Congress' more recent recognition of the role of financial subsidiaries *vis-a-vis* banks in the Gramm-Leach-Bliley Act,[23] and the fact that the Office of Thrift Supervision extended preemption rights to operating subsidiaries of federal savings associations in 1996, a "me too" rationale.[24]

The OCC rule is being challenged in litigation. Recently, the Second and Ninth Circuit Courts of Appeal upheld the regulation.[25] Both courts relied upon section 24 (Seventh) of the NBA and the *federal* incidental power clause to hold that national banks have the authority to conduct business through operating subsidiaries.[26] Both courts then deferred to the OCC operating subsidiary preemption rule.

The Ninth Circuit, however, noted that operating subsidiary existence arises under state law. These entities are not federally chartered, like their parents. Rather, they are incorporated under state law. Significantly, the court then observed: "This chartering distinction is the one irreducible difference between national banks and their operating subsidiaries, and precludes the direct transfer of the banks' immunity from state entry barriers, such as licensing requirements, to their operating subsidiaries."[27] After drawing this important distinction, the court, nevertheless, adopted the OCC's "alternative" argument in its *amicus* brief, *i.e.,* that the OCC's regulations regarding the establishment of operating subsidiaries by national banks are comprehensive and "finely calibrated" so as to preempt the field regarding the licensing of these companies.[28]

Second, even assuming that the analysis of these courts regarding the authority of the OCC under *federal* law is correct, the FDIC does not enjoy similar powers under the FDIA. The FDIA does not contain an independent corollary to section 24 (Seventh) of

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[22] 66 Fed. Reg. at 34,788.
[23] Pub. L. No. 106-102, § 121, 113 Stat. 1338 (1999) (codified at 12 U.S.C. § 24a(g)(3)). This Act appears to acknowledge the ability of national banks to own financial subsidiaries when it defined what constitutes a financial subsidiary. However, the GLB Act does not grant preemption rights to subsidiaries.
[24] 66 Fed. Reg. at 34,788. The OTS was the first agency to grant preemption rights to operating subsidiaries of a depository institution in 1996. 12 C.F.R. § 559.3(h), (n). .[24] However, a careful review of the provisions of the HOLA and the Federal Deposit Insurance Act upon which the OTS relied to promulgate this regulation reveals that Congress did not expressly address this issue. 12 U.S.C. §§ 1462, 1463, 1464, 1662a, 1828. In the Supplementary Information accompanying the regulation, the OTS simply relied upon its long-standing policy to treat the subsidiary in the same way as the parent federal savings association for purposes of preemption. *See* 61 Fed. Reg. 66,561, 66,563 (Dec. 18, 1996).
[25] Wachovia Bank, N.A. v. Burke, 414 F.3d 305 (2d Cir. 2005); Wells Fargo Bank, N.A. v. Boutris, 419 F.3d 949 (9th Cir. 2005).
[26] 12 U.S.C. § 24 (Seventh).
[27] Wells Fargo Bank, 419 F.3d at 965.
[28] This particular holding is unprecedented. There is nothing in the NBA itself or Supreme Court interpretations of it for the proposition that the OCC regulations can preempt the field regarding a particular issue. The Supreme Court applied express preemption principles regarding § 85 of the NBA (the usury provision) and otherwise has stated that conflict preemption principles are applicable. *See* Elizabeth Renuart & Kathleen Keest *Cost of Credit: Regulation, Preemption, and Industry Abuses* § 3.4.6 (3d ed. 2005); Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Threat to the Dual Banking System,* 23 Ann. Rev. Banking & Fin. L. 225 (2004).

the NBA. Rather, any incidental powers that state banks may have are granted by the law of the *state* in which they are chartered.[29] As a result, the FDIC may not extend Section 27 interest rate preemption beyond the state banks themselves to operating subsidiaries, agents, or third parties. The FDIC does not have the authority that the OCC arguably has to enact the regulations that the Ninth Circuit relied upon.

Moreover, to read section 27 so expansively would make it a *broader* grant of authority than that contained in section 85. National banks derive their exportation authority from section 85, but they derive the authority to use non-bank means to export the rates with minimum interference of host state law from the *combination* of NBA section 85 and the 'incidental powers' language set forth in section 24 (Seventh).[30] Under the incidental powers doctrine, the OCC has the express authority to issue regulations ensuring that national banks could avail themselves of "all such incidental powers as shall be necessary to carry on the business of banking."[31] There is no comparable grant of *federal* authority for state banks. In fact, the purpose behind this language stems from the original creation of the national banks in order to establish a uniform currency and to engender public trust in the banking system.[32] The first national banks were forced into dissolution by state interests, and Congress found that the national banks needed protection from anti-competitive state legislation that might frustrate the new federal banking scheme.[33] Section 27 alone does not give federally-insured state-chartered banks express federal powers to conduct interstate banking business through or in concert with non-banks, just as the NBA section 85 does not confer that authority on national banks.

Finally, the legality of the OCC rule is pending before the Fourth and Sixth Circuits.[34] The Supreme Court is likely to tackle the issue, especially if a conflict among the lower court develops. At the very least, the FDIC would be prudent to remove any reference to the preemption rights of operating subsidiaries until the Supreme Court has settled the issue for national banks.

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[29] John J. Schroeder, *"Duel" Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 Ind. L. Rev. 197, 202 (2003)(describing how express banking powers are enumerated in state banking codes and that most states included some type of incidental powers provision).

[30] "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 …." 12 U.S.C. § 24 (Seventh). This point is described more fully in Comments filed by the Center for Responsible Lending on May 16, 2005.

[31] See NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Corp., 513 U.S. 251, 258 n.2 (1995) ("We expressly hold that the 'business of banking' is not limited to the enumerated powers in section 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.")

[32] Patricia A. McCoy, BANKING LAW MANUAL § 3.02[1] (2d. ed. 2004).

[33] *Id.*

[34] National City Bank v. Turnbaugh, 367 F. Supp. 2d 805 (D. Md. 2005), *appeal pending*; Wachovia Bank, N.A. v. Watters, 334 F. Supp. 2d 957 (W.D. Mich. 2004), *appeal pending.*

Recommendation: Remove the discussion in the Supplementary Information regarding operating subsidiaries.

III. The FDIC Should Not Wholly Defer to OCC Interpretations of Section 85

We suggest that it is short-sighted public policy to defer by regulation to the OCC's interpretation of the parallel interest rate provision in the National Bank Act. The urge to do so is understandable, since the interest rate provision in the FDIA is almost identical to that in the NBA.

However, what if the FDIC disagrees with the OCC at some point in time regarding the definition of interest or the "location" of a bank for purposes of exportation? What if the OCC issued a preemption opinion without a notice and comment period as required by the Riegle-Neal Act?[35] Indeed, OCC Interpretative Letter No. 822 issued in 1998 suffers from exactly this defect. The FDIC heavily relied upon this opinion when it issued General Counsel Letter No. 11 and these proposed regulations.[36] The OCC Letter addresses the location of a national bank for purposes of interest rate exportation under section 85 and creates a cookbook for the preemption of host state law. As a result, it falls within the publication rule in the Riegle-Neal Act. However, the OCC did not issue this letter after a notice and comment period. Arguably it is void and entitled to zero deference. To our knowledge, the validity of the letter has not been challenged in court but it certainly could be.

On the other hand, FDIC constituent state banks desire certainty. They are likely to support a regulation that automatically applies any position taken in the future by the OCC on these issues to state banks. This need can be met by creating a presumption that an OCC interpretation of section 85 applies to state banks unless and until the FDIC issues an override. This regime protects the role of the FDIC as an independent agency with interpretive authority over section 27 but gives state banks certainty until such time as the FDIC disagrees with the OCC, should that occur. There is no need to commit now and forever to "tag-along" with the OCC. The hands of the FDIC would be tied unnecessarily.

Recommmendation: Amend the last sentence of proposed12 C.F.R. § 331.1(b):

> *To maintain parity with national banks under section 85 of the National Bank Act, the interpretations issued by the Office of the Comptroller of the Currency under section 85 will apply to insured state chartered banks so long as those interpretations comply with the requirements of 12 U.S.C. § 43 and unless and until the FDIC issues a regulation that amends or disavows the OCC interpretation at issue.*

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[35] *See* 12 U.S.C. § 43.

[36] *See* 70 Fed. Reg. 60028, n. 41.

IV. The Ability of States to Override Section 27 Preemption Must be Honored

The FDIC's proposed regulation states that interest rate preemption does not apply to state banks chartered in a state that has exercised (or could in the future exercise) its right to opt-out of section 27.[37] However, the regulation does *not* honor a state's opt-out where a loan is *made* in that state by a state bank chartered elsewhere. By failing to honor a state's override for loans *made* in that state, the regulation contravenes the both the express language of section 525 and the purpose of the absolute opt-out right granted by Congress contemporaneously with the enactment of section 27.

Section 525[38] states that a state may opt out of the "amendments made by…sections [521 through 523] [which] apply to loans *made* in such State…" Nowhere does Congress limit the override to loans made by banks *chartered* in the opt-out state.

Moreover, there is no intellectually honest way to make the argument that preserves the right to override a federal preemption statute with an agency rule which in practice makes that opt-out right a nullity. Congress granted the opt-out right recognizing two things: a) it was an intrusion onto an area of traditional state prerogative; and b) there is no room in our system for the sister-state preemption that results. While all but three jurisdictions which opted out originally have repealed their overrides, it is important to remember that there was no sunset on the section 525 opt-out. The Congressionally authorized right to "just say no" to this particular federal preemption itself is fundamentally incompatible with the claim that that same statute on the other hand gives the FDIC *implicit* authority to restrict that opt-out right in any way.[39]

Recommendation: Amend 12 C.F.R. § 331.5 as follows:

> *12 U.S.C. § 1831d does not apply to loans made to customers:*
> *(a) in a state that elects to opt-out of the coverage of 12 U.S.C. § 1831d pursuant to section 525 of DIDMCA; or*
> *(b) by an insured state bank or an interstate branch of a state bank located in a state that elects to opt-out of the coverage of 12 U.S.C. § 1831d pursuant to section 525 of DIDMCA.*

V. Scope of the Riegle-Neal Preemption Articulated in the Proposed Regulation Creates Loopholes Not Envisioned or Condoned by Congress

The Riegle-Neal Act provides that the laws of the host state applies to branches of state-chartered banks to the extent those state laws apply to national bank branches.[40]

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[37] Proposed 12 C.F.R. § 331.5.
[38] Now codified in a note to 12 U.S.C. § 1785(emphasis added).
[39] This argument was first articulated in Comments filed on May 16, 2005 by the Center for Responsible Lending and is re-stated here with permission.
[40] 12 U.S.C. § 1831a(j).

If the host state law does not apply to the branch, then the bank's home state law applies.[41] The preemption of state law permitted under this act does not apply outside of the interstate branching context nor does it apply to anything other than state *banks or their branches.*

The purpose of the Riegle-Neal amendments of 1997 was simply to put state-chartered banks on par with national banks *when state-chartered banks branch into another state.*[42] Riegle-Neal has nothing to do with the preemption of state law outside of the branching context and has nothing to do with the preemption rights of non-bank entities. Significantly, section 1831a(j) expressly applies the law of the host state to the business of branches except in certain circumstances:

> The laws of the host state, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, shall apply to any branch in the host state of an out-of-State State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank. To the extent host State law is inapplicable to a branch of an out-of-State State bank in such host State pursuant to the preceding sentence, home State law shall apply to such branch.[43]

The plain language of this provision accomplishes several goals. First, it applies only in the interstate branching context, *i.e.*, to banking activities *at branches*, not interstate banking in general. Second, the section speaks in the affirmative regarding the broad application of host state law. Third, Congress highlighted certain state laws of the host state that apply to a branch. Fourth, the provision identifies the circumstances under which the host state law may not apply, *i.e.*, the parity clause. Fifth, section 1813a(j) applies the law of the home state only to the extent that the host state's law does not apply due to the operation of this section.

Further, the Act is clear as to *whose* activities it covers. Section 1831a(j) is titled: "Activities of branches of out-of-state banks." Subsection (j)(1) applies the law of the host state to any *branch.* Further, subsection (j)(2) is titled "Activities of branches." It addresses activities conducted by a state *bank* that establishes a *branch* in a host state. This subsection allows state banks to conduct activities at its branches that either host state banks or national banks could perform. But subsection (j)(2) does *not* grant third parties the right to perform these banking activities or grant the non-bank entities preemption rights.

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[41] *Id.*
[42] Riegle-Neal Act, 12 U.S.C. § 1831a(j).
[43] 12 U.S.C. § 1831a(j).

Despite the clear language of the Act, the FDIC proposes to poke a hole in this Congressional fabric that will have serious consequences for consumers. Specifically, proposed 12 C.F.R. § 362.19 applies the Riegle-Neal preemption to "any activity conducted at a branch," which is defined very broadly. The proposed regulation states:

> The phrase "*activity conducted at a branch*" means activity of, by, though, in, from, or substantially involving, a branch.

In the Supplementary Information, the FDIC attempts to cloak this unwarranted expansion of Riegle-Neal in the guise of an "interpretation" of a so-called "ambiguous" statute.[44] As discussed, the statute is not ambiguous and the proposed regulation exceeds the FDIC 's authority.

Arguably, the regulatory language would permit third party actors who perform activities through, in, or substantially involving a branch to claim preemption of host state laws. In other words, if a national bank or a host state bank could engage in an activity that is performed by a third party and the third party conducts the activity through, in, or if it substantially involves the state bank branch, then the state bank's home state law would apply to the third party's activity. The regulation separates the activity performed from the bank branch itself. There is no requirement that the activity at issue be performed *by* the branch!

Examples of third party actors potentially eligible for preemption include mortgage brokers, appraisers, loan closing agents, title insurance companies, and credit insurance companies whom the states have traditionally regulated. This large loophole will create devastating results for consumers and completely undermine the historical role of state enforcement over these marketplace players. For example, *forty-eight* states regulate mortgage brokers.[45] The law of forty-eight states arguably would be eliminated.

Another example involves appraisers. In 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") in response to the savings and loan crisis.[46] Congress determined that "faulty and fraudulent" appraisals of real estate collateral led to savings and loan failures when the properties' values could not cover the loans after default. To solve this problem, Congress put several safeguards in place. Under FIRREA, appraisals conducted in connection with any federally related transaction must be written and performed by "individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision."[47] To this end, Congress authorized the *states* to establish *state* certification and licensing agencies to provide uniform standards for appraisers utilizing certain minimum criteria issued by the Appraiser Qualification Board of the Appraisal Foundation. Arguably,

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[44] The FDIC makes this argument at 70 Fed. Reg. at 60023-60024.

[45] *See* Elizabeth Renuart & Kathleen Keest, *Cost of Credit: Regulation, Preemption, and Industry Abuses* App. B (3d ed. 2005).

[46] *See* Fidelity Nat'l Info. Solutions, Inc. v. Sinclair, 2004 WL 764834 (E.D. Pa. Mar. 31, 2004).

[47] 12 U.S.C. § 3331.

proposed § 362.19(a)(4) would trump this explicit delegation of authority to the states by condoning the application of a state bank's home state law to the appraiser, rather than the state in which the appraiser does business.

When it enacted the Riegle-Neal Act, Congress did not intend to weaken the authority of states to protect the interests of consumers.[48] The Conference Report also stated that Congress also did not intend to change the substantive theories of preemption that existed in law at that time.[49] Congress directly instructed the Comptroller to refrain from concluding that a state law is preempted unless "the legal basis is compelling and the Federal policy interest is clear."[50]

For these reasons, the FDIC's regulation is overbroad and needs fixing.

Recommendation: To close this loophole, the FDIC should define "*activity conducted at a branch*" in 12 C.F.R. § 362.19(a)(4) as follows:

> *The phrase "activity conducted at a branch" means activity conducted by the branch at its facility in the host state.*

VI. Disclosure of the Applicable State Law Would Benefit Consumers

As noted by the FDIC, its General Counsel Letter No. 11 urged state banks to "make an appropriate disclosure to the customer that the interest to be charged on the loan is governed by applicable federal law and the law of the relevant state which will govern the transaction." The Supplementary Information accompanying the proposed rules request comments on whether disclosure of this information ought to be explicitly addressed in 12 C.F.R. § 331.4.

We suggest that a disclosure of this information can be helpful to consumers for at least two reasons. First, this type of notice would educate consumers that many of their credit agreements are governed by the law of a foreign state, a fact that is not widely understood. Second, a segment of consumer then will shop until they find a bank that applies the interest rate law of their *own* state. The behavior of these borrowers could have a salutary affect on the market when banks realize that consumers prefer to deal with local entities who apply local law to the relationship.

However, the disclosure must be clear and conspicuous. It should be separate from any choice of law provision. A requirement that the notice be separate from the contract provisions is critical for two reasons. First, the notice should not constitute a choice of law by the consumer because choice-of-law provisions are not "choices." They are simply part of the boilerplate language in a contract that a consumer must take or

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[48] H.R. Conf. Rep. No. 103-651 at 53 (1994), reprinted in 1994 U.S.C.C.A.N. 2074.
[49] *Id* at 53, 55, *reprinted in* 1994 U.S.C.C.A.N. 2074, 2076. The conference report went on: "This process is not intended to confer upon the agency any new authority to preempt or to determine preemptive Congressional intent in the [the area of consumer protection], or to change the substantive theories of preemption as set forth in existing law."
[50] Id. *at* 55, reprinted in 1994 U.S.C.C.A.N. 2076.

leave that inure to the benefit of the bank, not the consumer. Second, if a choice-of-law provision can constitute "disclosure," the consumer is unlikely to understand the importance of this information because these provisions are part of the small print in the contract, often appear at the end of the document, and are not noticeable.

Recommendation: The FDIC add new 12 C.F.R. § 331.6:

> **Notice of Applicable State Law**
>
> *In consumer transactions, as defined by 15 U.S.C. § 1602, an insured state bank shall disclose to the consumer the identity of the state whose law governs the transaction. The notice shall be made clearly and conspicuously in writing and shall be segregated from all other information. The insured state bank shall make the disclosure before consummation.*

VII. Conclusion

Congress created the federal banking system and the overlay of federal administration of state-chartered banks through the Federal Deposit Insurance Act. Congress empowered the FDIC to act only as a secondary regulator of state banks. Congress chose to grant most favored lender status regarding interest to national banks, federal savings associations, and state banks. Congress permits state banks to branch and those branches to perform certain activities subject to host state law under certain circumstances. Congress did *not* grant the FDIC the power to cloak non-ban k operating subsidiaries or third parties with the mantle of federal preemption rights. Nor does the FDIC have the authority to undermine the absolute right of states to override section 27 preemption. For the reasons we articulate above, we respectfully request that the FDIC accept the recommendations made in these comments.