April 2, 2001

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW, Mailstop 1–5
Washington, DC 20219

Re: Docket No. 01–01; Investment Securities; Bank Activities and Operations; Leasing; 66 Federal Register 8178; January 30, 2001

Dear Sir or Madam:

The Office of the Comptroller of the Currency ("OCC") is proposing several amendments to its regulations to update and revise them to reflect developments in the law and in the national banking system. The amendments will affect all national banks. The American Bankers Association ("ABA") brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and bank holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

1. Investment Securities

National banks have limited investment authority under 12 U.S.C. 24(Seventh). Among other restrictions, the total amount of investment securities of any one obligor held by a national bank for its own account generally may not exceed ten percent of the bank’s capital and surplus. Section 151 of the Gramm-Leach-Bliley Act ("GLBA") amended Section 24(Seventh) to exempt certain municipal bonds from the ten percent limit if the national bank is well capitalized under the statutory prompt

corrective action standards. The OCC proposes to amend its investment securities regulations by adding a definition of municipal bonds consistent with that definition in GLBA and to amend the definitions and restrictions on Type I, Type II and Type III securities to implement the provisions of Section 151 of GLBA. ABA supports the proposed amendments.

2. Bank Activities and Operations

The OCC proposes five amendments to the Interpretations in Part 7 dealing with bank activities and operations.

2a. School financial literacy programs not branches. The OCC proposes to add new Section 7.1021, which defines the circumstances under which a school where a bank participates in a financial literacy program is not considered a branch of the bank under the McFadden Act. Those circumstances include that the bank must not "establish and operate" the school premises or facility, as provided in Section 36 of the National Bank Act and judicial precedents for the creation of national bank branches.

Under those precedents determining whether a national bank has created a branch, first the court determines whether the national bank has "establish[ed] and operate[d]" the off-premises location in question. If so, the court goes on to determine whether the off-premises location is covered by the definition of the term ‘‘branch’’ because the off-premises location accepts deposits, pays checks, or lends money. In doing so, the court looks at the nature of the bank’s interest in the location in question and at the degree of control the bank maintains over the employees who work at the location or the business conducted there.

In order for there to be no branch, the proposed regulation requires that the bank have no property interest in the school location, that its employees would typically work at the school only in connection with their participation in the financial literacy program, and that the bank would exercise no control over the school, its teachers, or its curriculum. The proposed regulation also requires that the financial literacy program be principally intended to educate students. A program would be considered principally educational if it is designed to teach students the principles of personal economics or the benefits of saving for the future, without being designed for the purpose of making profits.

ABA supports the proposed interpretation. ABA notes that it supports just such financial literacy education in schools by its member banks through its ABA Education Foundation programs, such as Teach Children to Save and the Personal Economics Program.

2b. Legal holidays and mandatory closings. The proposal amends Section 7.3000 to conform it with the Comptroller’s statutory authority to declare mandatory bank closings, as provided in 12 U.S.C. 95(b)(1). The proposal clarifies that if the Comptroller or a State declares a legal holiday due to emergency conditions, a national bank may temporarily limit or suspend operations at its affected offices or it may choose to continue its operations, unless the Comptroller by written order mandates closure. ABA does not object to the proposal.

2c. Interest on credit extensions. The proposed rule revises current Section 7.4001 to clarify the scope of the term "NSF fees" for purposes of 12 U.S.C. 85. The proposal also revises current Section 7.4002, which governs non-interest charges and fees, to remove language that may be confusing. Section 7.4001 generally defines the charges that are considered ‘‘interest’’ for purposes of 12 USC 85, then sets out a nonexclusive list of charges covered by that definition. The list includes "NSF fees." The inclusion of "NSF fees" in the definition of "interest" was intended to codify a position the OCC took in an interpretive letter issued in 1988. That Interpretive Letter, No. 452, concluded that charges imposed by a credit card bank on its customers who paid their accounts with checks drawn on insufficient funds were "interest" within the meaning of Section 85. Interpretive Letter No. 452 referred to the charges in question as "NSF charges." The term, however, is also commonly used to refer to fees imposed by a bank on its checking account customers whenever a customer writes a check against insufficient funds, regardless of whether the check was intended to pay an obligation due to the bank. These different uses of the term "NSF fees" have created ambiguity about the scope of the term as used in Section 7.4001(a).

The proposal amends Section 7.4001(a) to clarify that the term "NSF fees" includes only those fees imposed by a creditor bank when a borrower attempts to pay an obligation to that bank with a check drawn on insufficient funds. Fees that a bank charges for its deposit account services—including overdraft and returned check charges—are not covered by the term "NSF fees," as that term is used in Section 7.4001. These fees are therefore not "interest" but, rather, are charges covered by 12 CFR 7.4002. ABA supports the clarification, but suggests alternative language, below.

In proposing the clarification of "NSF fees" under Section 7.4001, the OCC also requests comment on whether the term "NSF fees" should also include at least some portion of the fee imposed by a national bank when it pays a check notwithstanding that its customer's account contains insufficient funds to cover the check. The OCC notes that, as a matter of practice, banks often vary the amount of the charges they impose, depending on whether they honor the customer's check. The OCC suggests that a bank that pays a check drawn against insufficient funds may be viewed as having extended credit to the accountholder. Consistent with that approach, the difference between what the bank charges a deposit account customer when it pays the check and what it charges when it dishonors the check and returns it could be viewed as interest within the meaning of 12 U.S.C. 85. Currently, the OCC's regulation does not expressly resolve this issue.

ABA believes that the proposed rewording of Section 7.4001 and the additional question posed by the OCC may actually increase the ambiguity about the scope of the term "NSF fees" in Section 7.4001 and Section 7.4002. Banks traditionally have permitted deposit accounts to be overdrawn in two ways. First, a bank may enter into an overdraft protection line of credit agreement with its customer. Such an agreement binds the bank to advance credit over time to cover negative balances within a specified credit limit. Second, without a binding agreement, the bank may pay a check that overdraws an account, or return it if it chooses. If paid, the resulting overdraft typically is immediately due and payable. Such a discretionary payment does not obligate the bank to extend credit over time. Section 7.4001 has long included certain fees within the definition of interest for the purpose of exportation under 12 U.S.C. 85. But these fees usually have been included as interest only in the context of an agreement to extend credit. For example, a two-dollar monthly fee to maintain an overdraft line would be interest under 7.4001, therefore exportable if lawful in the state in which the bank is located. Similarly, if a credit agreement imposes a charge-back fee when a check has been drawn on insufficient funds is sent to pay down the credit line, that fee also is interest under 7.4001. On the other hand, the OCC's question as to whether "the difference between what the bank charges a customer when it pays the check and what it charges when it dishonors the check and returns it could be viewed as interest" within the context of Section 7.4001 raises unnecessarily complicated questions.

An NSF fee charged against a deposit account, without an overdraft agreement, has been consistently viewed by the courts as subject to the provisions of 7.4002 regulating non-interest charges.1 ABA is now concerned that the imprecise use of the term "NSF" to describe a variety of fees in both deposit and credit account contexts may contribute to an impression that NSF fees generally qualify as interest under 7.4001, possibly removing NSF fees on deposit accounts from coverage under 7.4002. The OCC has asked if a bank charges more to pay a deposit account into overdraft than it does to return the check, should the difference be considered interest and no longer regulated by 7.4002? ABA would suggest that, unless the debt is created pursuant to an overdraft agreement, the entire charge should be a non-interest charge. If imposed in connection with an overdraft agreement, the entire charge should be interest under 7.4001. To do otherwise would disturb settled law and would result in confusion among the public and the industry.

To prevent this confusion, ABA recommends that the OCC reword its proposed amendment to Section 7.4001 to read:

(a)* * * It [interest] includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, points, late fees, or charge-back fees that are imposed under a credit agreement (e.g., a borrower tenders payment on a line of credit with a check drawn on insufficient funds), overlimit fees, annual fees, cash advance fees, and membership fees. * * *

Additionally, ABA recommends that the OCC amend Section 7.4002, in addition to the OCC's proposed amendments discussed below, by adding to Subsection 7.4002(c) the following:

"Deposit account service fees imposed in connection with the issuance of checks (or other orders) on insufficient funds, such as NSF fees, fees for paying the check and for creating or maintaining an overdraft, are not "interest," except in cases where the depositor has a contractual right to defer payment of an overdraft."

2d. National bank non-interest charges. Additionally, the OCC proposes to amend Section 7.4002, on national bank's non-interest charges and fees, to address two concerns. First, the OCC would delete specific reference to charges on dormant accounts and fees for credit reports and/or investigations in order to prevent the examples from being interpreted as a limitation on the kinds and nature of fees and charges which national banks may assess. ABA supports the proposed change.

Second, the OCC rewrites Section 7.4002 to remove the language that a bank "reasonably establishes'' non-interest charges and fees if it considers the factors listed by the OCC among others. The OCC states that "[t]his language was intended to convey that the bank must exercise sound banking judgment and rely on safe and sound banking principles in setting charges and fees." However, recent litigation has sought to interpret this language as requiring a "reasonableness" on charging fees and charges, which was not the intent of the language. ABA supports the proposed rewording.

2e. Application of state laws to operating subsidiaries. The proposal adds a new Section 7.4006, which provides that state laws apply to a national bank operating subsidiary to the same extent that they apply to the parent national bank. The OCC believes that such a conclusion is mandatory, since operating subsidiaries have been authorized for national banks for decades, as being convenient or useful for the bank to conduct activities that the bank could conduct directly, through the alternate form of a controlled subsidiary company. Thus, operating subsidiaries and the activities they conduct are an embodiment of the incidental powers of their parent bank and often have been described as the equivalent of a department or division of their parent bank—organized for convenience in a different corporate form. Hence, that which applies to the bank perforce must apply to the subsidiary, including state laws. ABA does not oppose the proposal.

3. Leasing

The OCC proposes to amend its leasing regulations to further limit the amount of unguaranteed residual value relied upon by the bank for repayment. Presently, the OCC's regulations allow the unguaranteed amount of residual value relied upon by the bank to be as high as 25% of the bank's original cost of the property. The OCC last revised the leasing rules in 1996. Since then, the OCC's experience in supervising national banks that engage in the leasing business has suggested that the 25% residual value limit may not be appropriate for all types of personal property leasing. The OCC states that:

"[t]he OCC would modify current Section 23.21 to provide that the limit on the amount of estimated residual value is either 25% or the percentage for a particular type of personal property that is specified in guidance published by the OCC. Section 23.21 would then permit the OCC to establish a different percentage requirement than 25% if a different limit is warranted. If the OCC does not specify a different limit, the 25% limit would continue to apply. The OCC would apprise national banks of any different limit or limits established under this provision by publishing an OCC bulletin, which would subsequently be incorporated into the Comptroller's Handbook booklet on Lease Financing." [Emphasis added.]

The ABA has some procedural concerns about the proposal, since the OCC appears to be bypassing the Administrative Procedure Act ("APA") as it applies to agency rulemaking. Presently, the OCC may "establish a different percentage requirement than 25% if a different limit is warranted" by proposing to amend the regulation, requesting comment, reviewing comment and adopting a final amended regulation. What the OCC is proposing is not to gain the ability to change the percentage limit by particular type of personal property but rather to gain that ability without having to comply with the APA.

Admittedly, if the OCC could make these changes by publication in an OCC Bulletin, the OCC could more quickly respond to a perceived need for change by only having to issue a new OCC Bulletin. But the OCC and the industry lose important procedural safeguards by adopting this proposed amendment. Banks lose the opportunity to be alerted to the possibility of a change and a chance to comment on whether the proposed change should be adopted. The OCC loses both important input from bankers and certainty in enforcement. For example, difficult legal questions would arise if the OCC adopted the proposal. Suppose the OCC provided that auto leases would be subject to a 15% residual value limit, given recent OCC supervision experience with declining used auto values. Would national banks be subject to the new limit immediately or would there be a need for a transition period? As no comments would have been solicited on a proposed change, there is no clear answer. If a national bank persisted in using a 25% residual value on auto leasing, would the national bank's actions be a violation of a regulation or just a disagreement over a supervisory policy? Enforcement of a regulation is entirely different, for both bank and supervisor, from enforcement of a supervisory policy. ABA concludes that it would be better to follow the slower but more certain method of rulemaking for changing the permissible residual value for leasing of types of personal property than to adopt the OCC's proposal for a quicker but more problematic process. ABA reluctantly opposes the OCC's proposed amendment.

Conclusion

The American Bankers Association appreciates the opportunity afforded it to comment of these proposed changes. ABA has raised concerns about the proposed amendments to 12 CFR 7.4001 and 7.4002, which it hopes that the OCC will consider carefully before making any final changes. Also, ABA opposes the proposed change to the leasing regulations that would exempt changes in the residual value of leased personal property relied upon by the bank for repayment from the Administrative Procedure Act. If there are any questions about these comments, please call the undersigned.

Sincerely,
Paul A. Smith

In some cases, courts have been asked to decide whether overdraft charges on deposit accounts constituted finance charges under Regulation Z. Regulation Z defines credit as "the right to defer payment of debt or to incur debt and defer its payment." These courts generally have found that where there is no agreement by a bank to defer repayment of the overdraft, Regulation Z has not applied. This result is consistent with credit charges being controlled by 7.4001 and deposit charges by 7.4002.