Office of the Comptroller of the Currency

Interpretations - Letter 721

Published in Interpretations and Actions May 1996

Cites:

- *12 U.S.C. 36J2*
- *12 C.F.R. 7.1003*

March 6, 1996
[ ]
Dear [ ]:

This is in response to your letter of January 12, 1996, as supplemented by your letters of February 15, 1996, and March 5, 1996, inquiring whether the involvement of affiliated banks (the "affiliated banks") in certain procedures for originating and closing consumer loans made by an intrastate national bank, (the "lending bank") would violate branching laws applicable to the national bank or prevent that national bank, under 12 U.S.C. 85, from charging the interest rates permitted by the laws of the state in which it is located. For the reasons discussed below, none of the activities of the affiliated banks are considered by the OCC, under applicable law, regulation and precedent, to be branching activities. Therefore, we conclude that the affiliated banks performing those activities would not be considered to be branches of the lending bank. Moreover, the lending bank would be considered to be located, for purposes of 12 U.S.C. 85 ("Section 85"), in the state in which it has its main office. <**Note:** You have advised the OCC that the lending bank has no branches at this time.> Thus, it could charge interest rates permitted by the laws of that state as applied to national banks by Section 85.

I. Background

As we understand the facts, the banks involved are national bank and state bank subsidiaries of [ ], a bank holding company. The proposed services would be provided by banks affiliated with the lending bank to assist the lending bank in its lending activities involving secured and unsecured loans and lines of credit. You have stated that the activities to be undertaken by the affiliated banks pertain both to originating and closing the loans. With respect to originating the loans, the activities to be undertaken by the affiliated banks are making available information and brochures regarding credit products offered by the lending bank; providing blank credit application forms and appropriate application disclosures to individuals who express interest in obtaining credit from the lending bank; assisting individuals in completing applications; accepting completed loan applications from individuals; and transmitting all such applications to the lending bank. With respect to closing loans, the activities to be undertaken are scheduling closing dates with applicants whose loans have been approved; preparing necessary documents such as a credit agreement or mortgage in the event that the applicant has been approved for a line of credit; obtaining the necessary signatures of the borrowers, mortgagors and other required parties; and delivering to borrowers a book or line of credit checks or other access devices if a loan is represented by a line of credit.

In the event, however, that the approved loan is a closed-end credit, the loan proceeds would be transferred on the closing date by ACH, wire transfer or other electronic method, by the lending bank to a deposit account of the borrower at the affiliated bank. Alternatively, the lending bank would transfer the loan proceeds by wire transfer or other form of electronic transfer, on or prior to the closing date, to a settlement account held in and by the affiliated bank. At settlement, the affiliated bank would issue to the borrower its own cashier's check drawn on the settlement account at the affiliated bank. You note that this method of facilitating the receipt by borrowers of funds is standard practice in the lending industry whenever closing agents are used, such as in the residential mortgage industry, for a variety of reasons. Among the reasons which you cite for transferring funds via wire transfer to an account of the closing agent rather than having the lending bank pay the borrower directly, by issuing a check to the borrower or having the closing agent draw a check on the funds of the lender, are that it is less costly than the courier expenses that would be involved in sending the lending bank's funds in the form of a cashier's check to the closing agent, reduces the risk of fraud or loss during the transfer, can be accomplished in a more timely manner, and reduces the chance of error that the bank acting as closing agent would inadvertently use the wrong cashier's checks in a variety of transactions if it had to hold two stocks of cashier's checks -- its own and those of the lending bank.

In addition to transferring funds to the affiliated bank, the lending bank, upon receiving applications transmitted by the affiliated bank, would take all necessary steps to complete the application file including obtaining credit reports, verifying application information, ordering appraisals, underwriting the application and making the credit decision to approve or deny the application.

You have stated that at all times during the application process, the affiliated bank will clearly disclose that the application is being taken on behalf of the lending bank and that all credit disclosures and agreements will clearly identify the lending bank as the creditor. If an application is approved, the lending bank would communicate that approval by telephone or fax to the affiliated bank and, if the customer were still on the premises of the affiliated bank, the affiliated bank would orally inform the customer that their "application for credit from [specific name of lending bank] has been approved." <**Note:** You expect that these in-person oral approvals would not be uncommon since the bank anticipates that many loan decisions could occur in under an hour.> If the customer were no longer on the premises, the affiliated bank would contact the customer by telephone to give this notice of approval. If an application were denied, and the applicant were still on the premises of the affiliated bank, either the adverse action notice identifying the lending bank as the creditor would be printed on a remote printer located on the affiliated bank's premises and delivered by the affiliated bank to the applicant or the affiliated bank would orally inform the applicant of the denial in person and the lending bank would mail the written adverse action notice to the applicant. If the applicant were not still on the premises of the affiliated bank, the adverse action letter would be mailed by the lending bank to the applicant.

I. Analysis

To be a branch, a facility must satisfy a number of requirements. It must offer at least one of the "core" activities listed in 12 U.S.C. 36(j), namely receiving deposits, paying checks, or lending money. *Clarke v. Securities Industry Association,* 479 U.S. 388 (1987). In addition, a facility must be "established, *i.e.* owned or rented, by the bank." *Independent Bankers Association of America v. Smith,* 534 F.2d 921 (D.C. Cir.), *cert. denied,* 429 U.S. 862 (1976) ("*Smith*"); *Independent Bankers Association of New York v. Marine Midland Bank,* 757 F.2d 453 (2d Cir. 1985), *cert. denied,* 476 U.S. 1186 (1986) ("*Marine Midland*"). Finally, the convenience to the public of the facility's location must give the bank a

competitive advantage in obtaining customers. *First National Bank in Plant City v. Dickinson*, 396 U.S. 122 (1969). For a more detailed discussion of these requirements, *see generally* Interpretive Letter No. 634, [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,520 (July 23, 1993) (Interpretive Letter No. 634). Most courts that have examined the issue have concluded that "money" is "lent" for purposes of the McFadden Act at the time and place that a borrower receive bank funds. *Smith*, 534 F.2d at 946 n.95; *Illinois v. Continental Illinois National Bank*, 409 F. Supp. 1167 (N.D. Ill. 1975) ("*Continental Illinois*"). Since the loan origination steps listed above include only steps preliminary to the lending of money, it is clear that this alone does not constitute the lending of money within the meaning of the McFadden Act. Therefore, the OCC has long taken the position that loan production offices are not branches and are not subject to geographic restrictions. *See* 12 C.F.R. 7.7380. <**Note:**This interpretive ruling has been upheld by the Court of Appeals for the District of Columbia Circuit on grounds of laches. *Independent Bankers Association of America v. Heimann*, 627 F.2d 486 (D.C. Cir. 1980). The ruling, while still currently in effect, has been recodified effective April 1, 1996, at 12 C.F.R. 7.1004. *See* 61 Fed. Reg. 4849, 4863 (February 9, 1996). The substance of the rule, however, has been left unchanged. *Id.* at 4851.> Thus, with respect to these activities, the affiliated banks would be acting as nothing more than loan production offices on behalf of the lending bank within the explicit parameters of section 7.7380. <**Note:** We note, in this regard, that section 7.7380 explicitly permits a national bank to "utilize the services of persons . . . not employed by the bank for originating loans." 12 C.F.R. 7.7380(a). Thus, the fact that these services are provided by an affiliate does not remove the proposed activities from the parameters of that section. Similar language is retained in the rewritten regulation as codified at 12 C.F.R. 7.1004(a). *See* 61 Fed. Reg. 4863 (February 9, 1996).>

We recognize, however, that your proposal goes beyond the specific parameters of section 7.7380 as involved in the *Heimann* decision in that you also propose closing the loan at the loan production office and, in some instances, handing a check to the borrower at that facility. That, however, does not mean that the facility is a branch within the meaning of the McFadden Act. The OCC long has recognized that section 7.7380 is a safe harbor, not an exclusive definition. Merely because a facility falls outside of its scope does not mean that it necessarily violates the branching laws. *See, e.g.*, Interpretive Letter No. 634; Interpretive Letter by Richard V. Fitzgerald, Chief Counsel (June 26, 1987) (unpublished).

As discussed, the cases addressing what constitutes branching, within the meaning of the McFadden Act in the lending context, focus on the disbursement of bank funds to a borrower. *See Smith* and *Continental Illinois*. Consequently, the OCC has taken the position that loan activities short of in-person disbursal to the borrower by the bank, or at its facilities, of bank funds representing loan proceeds do not constitute branching. For instance, the OCC has long taken the position that approval of a loan is a back office function that can be undertaken by a lending bank at any site, whether or not a main or branch office. *See, e.g.*, Interpretive Letter No. 343, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,513 (May 24, 1985); Interpretive Letter No. 667, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,615 (October 12, 1994). *See also, e.g.*, Interpretive Letter by Thomas G. DeShazo, Deputy Comptroller of the Currency (April 5, 1973) (unpublished); Interpretive Letter by Roberta W. Boylan, Assistant Director, Legal Advisory Services Division (October 21, 1980); Interpretive Letter No. 634; Interpretive Letter by Christopher C. Manthey, Senior Attorney, Bank Activities and Structure (December 22, 1994) (closings not constituting branching functions) (unpublished). Consequently, it is clear that the various functions listed above related to the closing of the loans, short of disbursing loan proceeds, do not constitute branching functions.

Finally, the two methods that you propose to disburse loan proceeds do not constitute branching. The mere crediting by the lending bank of loan proceeds to a deposit account of the borrower at the affiliated bank without any in-person contact between the lending bank and borrower constitutes a back office

function not subject to branching limitations. *See* Interpretive Letter by Mr. Manthey (December 22, 1994) (unpublished). *Cf., e.g.* Interpretive Letter No. 634 (and letters cited therein explaining that back office functions of banks not involving in-person contact with customers do not implicate branching limitations). Any subsequent in-person withdrawals by the customer of those funds from his or her deposit account at the affiliated bank would constitute a branching function within the meaning of the McFadden Act. *See Smith* at 942-945. However, that transaction would comport with the branching statutes because it would be undertaken at a branch of the customer's bank of deposit.

Additionally, branching limitations would not be violated when the affiliated bank issues its own cashier's check drawn on an account held in its own name, for the benefit of borrowers, and delivers those checks to the borrowers as part of the closing transaction. *See* Interpretive Letters by Mr. Manthey (December 22, 1994 and August 22, 1995) (unpublished) (checks drawn by escrow agent on his or her own account are funds of escrow holder, not lender; thus, since bank funds are not delivered to the borrower at the closing, the loan is not "made" for branching purposes at that time). These interpretations have now been adopted by the OCC in the form of a final rule, to be codified at 12 C.F.R. 7.1003(a). *See* 61 Fed. Reg. 4849, 4863 (February 9, 1996). <Note: Section 7.1003(a) provides:

> (a) *General.* For purposes of what constitutes a branch within the meaning of 12 U.S.C. 36(j) and 12 C.F.R. 5.30, 'money' is deemed to be 'lent' only at the place, if any, where the borrower in-person receives loan proceeds directly from bank funds:
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> (1) From the lending bank or its operating subsidiary; or
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> (2) At a facility that is established by the lending bank or its operating subsidiary.

Id. at 4863. In explaining this provision, the OCC stated that this language:

> clarifies that the key portion of a loan transaction for branching purposes is in-person receipt by the borrower from the bank or on bank premises of loan proceeds directly from bank funds--not disbursement by the bank through any mechanism, nor disbursement of funds that at the time of receipt by the borrower are not bank funds . . . .

Id. at 4852.>

Consequently, I conclude that if the lending procedures undertaken by the affiliated bank comport with your description, the office of the affiliated bank would not be considered to be a branch for purposes of 12 U.S.C. 36. <**Note:**Because of the basis on which we have resolved this issue, it is not necessary to consider whether the proposed activities of the affiliated banks would come within the parameters of the OCC's interpretive letters permitting affiliated banks to provide accommodation services to customers of each other. *See*, *e.g.*, OCC Interpretive Letter No. 610, [1992-93 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,448 (October 8, 1992). It is also unnecessary to consider whether any or all of the proposed activities are authorized under 12 U.S.C. 1828(r) (permitting on a nonexclusive basis and with certain limitations affiliated banks to provide certain services as agent for each other). Likewise, it is not necessary to consider whether the facilities of the affiliated banks should be considered to be "established" by the lending bank for branching purposes within the meaning of the McFadden Act. *See*, *e.g.*, *Marine Midland* at 462-63; *Cades v. H & R Block*, 43 F.3d 869, 874 (4th Cir. 1994), *cert. denied*, 115 S.Ct. 2247 (1995). >

You also have asked whether the performance of these services by an affiliated bank in one state would affect the authority of the lending bank solely in another state to charge interest in accordance with the laws of the state in which the main office of the lending bank is located as those state laws are applied to national banks through 12 U.S.C. 85 ("Section 85"). Section 85 provides several alternative interest rates that a national bank may charge. The first alternative provides that "[a]ny association may . . . charge on any loan . . . interest allowed by the laws of the State . . . where the bank is located . . . ." <**Note:**The other alternatives are that the bank may charge one percent above the Federal Reserve discount rate on commercial paper and that where the laws of any state permit a different rate for banks organized under state laws, that rate is permissible for national banks organized or existing in that state. Where state law does not fix a rate, the statute permits national banks to

charge the greater of up to seven percent or up to one percent above the Federal Reserve discount rate on commercial paper.> For purposes of Section 85, it is beyond dispute that a national bank is "located" in the state of its main office. *See Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). After considering the history and purposes of Section 85 in two recent opinion letters, the OCC has concluded that for purposes of Section 85, a national bank also is located in each state in which it has a branch. *See* Interpretive Letter No. 686, [Current Binder] Fed. Banking Law Rep. (CCH) 81-001 (September 11, 1995); Interpretive Letter by Julie L. Williams, Chief Counsel (January 31, 1996) (unpublished) (the Williams letter). Upon determining that a bank was "located" in more than one state for purposes of Section 85 because it had its main office and/or branches in more than one state, those letters then analyzed whether the interest rates authorized under the laws of one of those states in which the national bank involved was located were incorporated into Section 85 and could be charged by the bank. The OCC determined that whether the laws of one of those states could be charged depended on whether there was a clear nexus between the loan transaction and the main office or a branch office of that bank located in the state the laws of which the national bank sought to apply. *See* Interpretive Letter No. 686 and the Williams letter. The bank in the present situation -- with only a main office and no branch offices -- is "located," for purposes of Section 85, in only one state. Consequently, that state's usury laws are the only usury laws incorporated under Section 85 and the interest rates that the bank charges must be in accordance with those state laws as applied to national banks by Section 85. Consequently, because under these facts, there is no choice that could be made by the bank with respect to the applicability of the usury law of more than one state, there is no need to -- nor could we -- undertake the second stage of the analysis which requires a determination of a clear nexus between the loan transaction and a bank branch or main office. In this situation, there simply is no branch office of the lending bank in any state with which a clear nexus could exist.

In summary, the lending bank would not be "located" in the state of an affiliated bank and would have no basis, under the first alternative interest rate set forth in Section 85, to charge interest permitted under the laws of any state except the one state in which its main office is located. <**Note:** We note also that this result is consistent with that reached under an analysis of the agency banking provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (enacted September 29, 1994) (the "Act"). While we do not rely on those provisions in reaching our conclusions about the permissibility of the agency banking functions that you propose, we note that Section 111 of the Act (the "savings clause") provides that:

> No provision of this title and no amendment made by this title to any provision of law shall be construed as affecting in any way--
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> (3) the applicability of [S]ection 85 or [the usury provisions] of the Federal Deposit Insurance Act.

The sponsor of this provision, Senator Roth, in discussing its impact on the applicability of Section 85 to interstate banks, made it clear that a lending bank that utilized an affiliated bank in another state to engage in ministerial functions related to its lending activities would not lose the ability to charge rates permitted to it by the state in which it was located. As Senator Roth stated, when one combines the agency banking provisions of the Act with the savings clause:

> [I]t is clear that the conferees intend that a bank in State A that approves a loan, extends the credit, and disburses the proceeds to a customer in State B, may apply the law of State A even if the bank has a branch or agent in State B and even if that branch or agent performed some ministerial functions . . . ."

140 Cong. Rec. S12790 (daily ed. Sept. 13, 1994). Significantly, Senator Roth distinguished between the "actual disbursal of proceeds" -- which in the case at issue would be done by the lending bank -- and "delivering previously disbursed funds to a customer" -- which in the case at issue would be done by the affiliated bank and which was considered by Senator Roth to be a "ministerial function." *Id*. at S12789. Thus, the facts at issue here are analogous to those foreseen by Senator Roth. A similar approach is reflected in case law. *See Cades*, 43 F.3d at 873-74

(national bank in Delaware which approved loan in Delaware, originated proceeds in Delaware and transmitted them to South Carolina for disbursal to borrower, could charge rates permitted under Delaware law even though agents of bank in South Carolina solicited borrower in a face-to-face transaction and all relevant documents were signed in South Carolina).>

I hope that this has been responsive to your inquiry.

Sincerely,
/s/
Eric Thompson
Director, Bank Activities and Structure