

Penhome



Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

October 17, 1994

[REDACTED]

RE: Operating Subsidiaries and Federal Preemption

Dear [REDACTED]

This responds to your letter submitted on behalf of [REDACTED], F.S.B., a Federally-chartered savings bank ("Association"), and wholly-owned subsidiary of [REDACTED], and on behalf of [REDACTED], a state-chartered wholly-owned operating subsidiary of the Association ("Operating Subsidiary"), inquiring whether certain state laws regulating lending are inapplicable to the Operating Subsidiary by reason of federal preemption.

As indicated when the Office of Thrift Supervision ("OTS") first issued its operating subsidiary regulation in 1992, operating subsidiaries are viewed as divisions or departments of their parent federal savings associations for virtually all regulatory purposes, including federal preemption. Accordingly, the same state laws that the OTS and its predecessor, the Federal Home Loan Bank Board ("FHLBB"), have found to be inapplicable to federal savings associations by reason of federal preemption are also inapplicable to their operating subsidiaries. Due to limited staff resources, we have not reviewed each of the fifteen different state statutes you cite in your letter of inquiry. We have, however, reviewed two representative state statutes and conclude that they are in fact preempted. The principles we lay out below should enable you to complete an analysis of the other thirteen states.

I. Background

The Association and the Operating Subsidiary are both located in Illinois. The Association no longer originates or services any first mortgage loans secured by single family dwellings. All mortgage banking operations, including the origination and servicing of first mortgage loans on single family dwellings are conducted by the Operating Subsidiary either through direct originations in Illinois or through a network of loan correspondents and mortgage brokers in several states throughout the country. Where necessary, the correspondents and

brokers are licensed and/or qualified to do business in the jurisdictions where they originate loans.

In the future, the Operating Subsidiary may seek to open direct loan origination offices in states other than Illinois. The Operating Subsidiary also maintains an office in ██████████ Florida. This office handles the purchase of loans from correspondents and brokers in several southeastern states but the office does not originate loans directly.

You have asked us about laws in fifteen states that regulate lending activities and that could affect the activities of the Operating Subsidiary if it seeks to expand its direct lending. You indicate that each of these laws regulates various aspects of mortgage and consumer lending. As indicated above, due to limited staff resources, we have limited our review to the statutes you have cited to two representative states, Arizona and Maine.

The statutory provisions you cite for the State of Arizona require any company that wishes to engage in the mortgage banking business in that State to file an application for a license, register to do business, post bond and maintain a minimum net worth.¹ The statutory provisions you cite for the State of Maine require any company that wishes to originate consumer loans in that State to file an application for a license and to demonstrate that it is financially responsible and of fit character. The Maine statute also prohibits lenders from taking a security interest in real property for consumer loans under a specified amount.²

II. Discussion

Federal savings associations are subject to strict federal regulation of the types and amounts of investments they may make in subsidiary corporations. Subject to certain narrow exceptions, a federal savings association may invest in a subsidiary corporation only if the subsidiary meets the federal statutory and regulatory standards for classification as either an "operating subsidiary" or a "service corporation."

A subsidiary is classified as an operating subsidiary only if, inter alia: (i) the activities of the subsidiary are restricted exclusively to those that a federal savings association may engage in directly; and (ii) voting control and effective operating control of the subsidiary is maintained at

1. See Ariz. Rev. Stat. Ann. § 6-941 et. seq. (West Supp. 1991-92).

2. See Me. Rev. Stat. Ann. Tit. 9-A, § 2-301 et. seq. (West Supp. 1993).

all times by its parent savings association.³ Provided these criteria are met, federal savings associations are permitted to invest unlimited amounts of their assets in operating subsidiaries.

A "service corporation" differs from an operating subsidiary in several important respects. Although the stock of a first-tier service corporation must be owned exclusively by savings associations, a service corporation need not be controlled by any one savings association.⁴ Thus, for example, multiple savings associations could each hold a small stake in a single service corporation. Moreover, a service corporation is permitted to engage in any activity that is "reasonably related" to the business of federal savings associations.⁵ Consequently, service corporations can engage in certain activities that federal savings associations cannot, such as real estate management and development.⁶ For this reason, the aggregate service corporation investments of a federal savings association are limited to no more than 3% of total assets.

Given these characteristics of a service corporation, neither the OTS nor the FHLBB has found it necessary to assert a preeminent or exclusive right to regulate service corporations free from state regulation. Put otherwise, neither the OTS nor the FHLBB has occupied the entire field of service corporation regulation. Thus, service corporations are subject to the full scope of state law, except where there is a specific conflict between state law and applicable federal law, in which case federal law prevails.

Operating subsidiaries are quite different. As noted above, operating subsidiaries are strictly limited to activities authorized for federal savings associations, can receive unlimited investments from their parent federal savings association, and must be controlled by a single federal savings association. For these reasons, operating subsidiaries have traditionally been viewed as mere operating departments or divisions of their parent savings associations.⁷ Because federal

3. 12 C.F.R. § 545.81(b)(1994).

4. 12 U.S.C.A. § 1464(c)(4)(B)(West Supp. 1994).

5. 12 C.F.R. § 545.74(c)(1994).

6. 12 C.F.R. § 545.74(c)(3)(1994).

7. 12 U.S.C.A. § 1464(c)(4)(B)(West Supp. 1994).

8. FHLBB Op. Gen. Counsel, November 21, 1988; and FHLBB Op. Dep. Gen. Counsel, August 13, 1985.

9. 57 Fed. Reg. 48942, 48945 (Oct. 29, 1992).

savings associations are able to invest unlimited amounts of their assets in operating subsidiaries, the success or failure of an operating subsidiary can have a huge impact on its parent savings association.

Congress has given the OTS a statutory mandate to regulate federal savings associations in a manner that preserves safety and soundness, protects the federal deposit insurance funds, and promotes the provision of credit for homes and other goods and services in accordance with the best practices of thrift institutions in the United States.¹⁰ Given the symbiotic relationship between federal savings associations and their operating subsidiaries, the OTS cannot fulfill these statutory mandates unless it regulates operating subsidiaries in the same manner and to the same extent as it regulates their parent institutions.

Many courts have recognized that, pursuant to HOLA § 5(a), the OTS is authorized to promulgate comprehensive regulations governing every aspect of the operations of federal savings associations from their corporate cradle to their corporate grave.¹¹ Pursuant to the authority vested in it by HOLA § 5(a), the OTS and its predecessor have for years extensively regulated the affairs of subsidiaries of federal savings associations. This authority has never been seriously questioned. The courts have also recognized that regulations promulgated pursuant to HOLA § 5(a) may preempt state law when deemed necessary or appropriate by the OTS to further the statutory objectives of the HOLA.

Acting pursuant to the authority granted to it by HOLA § 5(a), the OTS included the following provision in its operating subsidiary regulation:

Unless otherwise provided by statute, regulation, or policies of the OTS, all provisions of federal laws, regulations and policies of the OTS applicable to the operations of a federal savings association shall apply in the same manner and to the same extent to the

10. 12 U.S.C.A. § 1464(a)(West Supp. 1994).

11. Conference of Federal Savings & Loan Associations v. Stein, 604 F.2d 1256, 1260 (9th Cir. 1979); Rettig v. Arlington Heights Federal Savings & Loan Association, 405 F. Supp. 819 (N.D. Ill. 1975).

12. E.g., Fidelity Federal Savings & Loan Association v. de'la Cuesta, 458 U.S. 141 (1982); Morse v. Mutual Federal Savings & Loan Association of Whitman, 536 F. Supp. 1271 (D. Mass 1982); Glendale Federal Savings & Loan Association v. Fox, 459 F. Supp. 903 (C.D. Ca. 1978); People v. Coast Federal Savings & Loan Association, 98 F. Supp. 311 (S.D. Ca. 1951).

operations of its operating subsidiaries, and the parent association and its operating subsidiary shall generally be consolidated and treated as a unit for the purpose of applying appropriate statutory and regulatory requirements and limitations.

The practical effect of this provision is to occupy the field of operating subsidiary regulation to the same extent as the OTS has occupied the field of federal savings association regulation -- no more, no less. So as to make this intention manifestly clear, the preamble commentary on this regulatory provision states that:

[S]tate laws that apply to the activities of an operating subsidiary will be preempted to the same extent as when the activities are conducted directly by a federal savings association.

It is well established that the OTS lending regulations applicable to federal savings associations (and thus to operating subsidiaries) occupy the entire field of lending regulation, leaving no room for supplemental state requirements.¹⁵ Several former OTS opinions have specifically concluded that state licensing and registration laws such as those described above in Part I of this letter have no application to federal savings associations.¹⁶ For the reasons set forth above, this conclusion applies with equal force to operating subsidiaries.¹⁷

13. 12 C.F.R. § 545.81(e) (1994).

14. 57 Fed. Reg. at 48946.

15. OTS Op. Senior Dep. Chief Counsel, April 13, 1993; OTS Op. Senior Dep. Chief Counsel, November 20, 1992; OTS Op. Senior Dep. Chief Counsel, January 9, 1990; FHLBB Op. Gen. Counsel, April 28, 1987; and FHLBB Op. Acting Gen. Counsel, October 29, 1976. As is noted in these opinions, the OTS has occupied the field of lending regulation so as to prevent the imposition of multiple, duplicative, or conflicting state requirements that can restrict, or add unnecessary costs, to the operations of federal savings associations and thus adversely affect both safety and soundness and credit availability. Because operating subsidiaries are such an integral part of the operations of federal savings associations, these objectives cannot be achieved unless the same regulatory approach is applied to operating subsidiaries.

16. Id.

17. Although we recognize that operating subsidiaries are state chartered corporations, it is well established that the federal government can preempt the application of state law to state corporations, or even occupy an entire field of regulation affecting state corporations, when doing so furthers a valid

In reaching the foregoing conclusions, we have relied on the facts recited above in Part I of this letter, which are based upon representations in your letter to us dated March 3, 1994. Our conclusions depend upon the accuracy and completeness of those facts. Any material change in circumstances might require different conclusions.

If you have any further questions regarding this matter, please feel free to contact Catherine Shepard, Senior Attorney, at (202) 906-7275.

Very truly yours,


Carolyn B. Lieberman
Acting Chief Counsel

cc: Regional Director
Regional Counsel
Central Region

(Footnote 17 continued from previous page)
federal objective. E.g., Hillsborough County, Fla. v. Automated Medical Laboratories, Inc., 471 U.S. 707 (1985); Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691 (1984); and Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).