Applicability of Law (Proposed § 34.4)

The current rule states specific areas where Federal law preempts State law governing real estate lending by national banks. The proposal retains this statement of preemption in order to provide continued guidance about specific areas where Federal law preempts State law. However, the proposal removes the unnecessary reminder, found at current § 34.2(b), that national banks must comply with applicable laws.

Proposed § 34.4(b) adds a general statement of the OCC's position with respect to preemption to clarify that the list of areas where State law is preempted, carried over from the current rule, is not exhaustive. The proposed rule clarifies that the OCC will apply traditional principles of Federal preemption when determining whether a State law affecting real estate lending is preempted. Under these principles, State laws apply to national banks unless the State law expressly or impliedly conflicts with Federal law, the State law stands as an obstacle to the accomplishment of the full purposes and objectives of the Federal law, or Federal law is so comprehensive as to evidence a Congressional intent to occupy a given field.[1]

Due-On-Sale Clauses (Proposed Section 34.5)

Current § 34.4 authorizes a national bank to make or acquire a loan secured by a lien on real property that includes a due-on-sale clause, and preempts State law to the contrary. The rule also states that due-on-sale clauses in transfers described in 12 U.S.C. 1701j-3(d) are not enforceable.

The OCC proposes to modify this section to improve clarity and to remove unnecessary restatements of statutory provisions. The proposed descriptions of the terms ''real property'' and ''lender'' remove provisions that merely restate the statute. However, the proposal intends no change in the substance of those descriptions.

Subpart B—ARMs

The proposal renumbers current sections in subpart B, beginning with proposed § 34.20, in order to permit future additions to subpart A with minimum disruption.

Definitions (proposed Section 34.20)

Current § 34.5 contains definitions of ''adjustable-rate mortgage loan'' (ARM loan) and ''consumer credit.'' Proposed § 34.20 amends the definition of ''ARM loan'' by deleting the provisions, found in current § 34.5(a)(2), that exempt fixed-rate extensions of credit that are payable either on demand or without any interim amortization. Earlier OCC definitions of ''ARM loan'' included certain fixed-rate loan transactions, unless a lender gave the disclosures required to exempt the transaction from the regulation's coverage. (*See, e.g.,* 48 FR 9506 (March 7, 1983).) The OCC amended its rule in 1988 (53 FR 7885 (March 11, 1988)) to remove those disclosure requirements, and clarified that the fixed-rate extensions in question would not be considered to be ARM loans. While the express exemptions were helpful when the disclosure requirement was removed in 1988, such exemptions no longer are necessary.

The OCC seeks comment on whether it remains necessary or appropriate to exempt from the definition of ''ARM loan'' fixed-rate loans that are payable at the end of a term that, when added to all terms for which the bank has promised to refinance the loan, is shorter than the term of the amortization schedule. This exemption is similar, but not identical, to the treatment of variable-rate transactions in Regulation Z (Reg. Z, 12 CFR part 226) of the Board of Governors of the Federal Reserve System (the Federal Reserve). For instance, a loan that a bank has guaranteed to renew for a total period that is shorter than the life of the mortgage is not an ARM loan under part 34. (*See* 12 CFR 34.5(a)(2)(ii).) It is, however, a variable-rate transaction under Reg. Z. (*See* Commentary to § 226.17(c)(1), Comment 11, first bullet.) This distinction requires lenders to understand and apply two different standards, depending on the purpose being served.

The practical effect of this distinction is that national banks making balloon notes that are renewable for a total period shorter than the amortization schedule do not have to use an independent index in adjusting the interest rate on such loans. The distinction also raises the issue of whether banks find it unnecessarily burdensome to comply with the different rules.

Whatever burden that is created by the current difference could be eliminated by deleting all current exemptions from the OCC's definition of ARM loan and clarifying that a balloon note that a bank guarantees to renew will be treated as an ARM loan if the bank may adjust the interest rate upon renewal. This would result, however, in more loans being considered to be ARM loans, thereby increasing the number of loans for which a bank would have to use an index beyond the bank's control.

The OCC seeks comment on (1) whether the current difference between part 34 and Reg. Z poses an unnecessary burden, and (2) whether banks favor amending part 34 to eliminate the difference, notwithstanding that such approach would result in more loans being subject to the requirement that a bank use an index beyond its control.

In addition to the changes noted, the proposal makes stylistic changes to the definition of ''ARM loan.'' The proposal also deletes the definition of ''consumer credit,'' because other changes make the definition unnecessary (*see* discussion of ''Rate changes (current § 34.8)'' and ''Disclosure (current § 34.10)''). In order to consolidate all definitions used in subpart B, the proposal relocates to proposed § 34.20 the definitions of ''affiliate'' and ''subsidiary'' currently found in § 34.6(b). Finally, the proposal uses the term ''renewal'' instead of ''refinance'' as that term is used in current § 34.5(a)(2) in order to avoid creating the impression that the OCC rule applies to refinancings as that term is narrowly defined in Reg. Z.

General Rule (Proposed Section 34.21)

Current § 34.6 provides that national banks and their subsidiaries may make, sell, purchase, participate, or otherwise deal in ARM loans, notwithstanding any State law to the contrary. National banks may purchase or participate in ARM loans that were not made in accordance with the OCC's regulations, except that loans purchased from an affiliate or subsidiary must comply with part 34. The proposal makes only minor changes to simplify the general rule.

Index (Proposed Section 34.22)

Current § 34.7 requires ARM loans that are subject to 12 CFR 226.19(b) to specify an index to which changes in the interest rate shall be linked. The

[1] The Supreme Court's most recent discussion of the principles of Federal preemption may be found in *Gade* v. *National Solid Wastes Management Ass'n,* 120 L. Ed. 2d 73 (1992), in which the Court stated:

As both the majority and dissent acknowledge, we have identified three circumstances in which a federal statute pre-empts state law: First, Congress can adopt express language defining the existence and scope of pre-emption. Second, state law is pre-empted where Congress creates a scheme of federal regulation so pervasive as to leave no room for supplementary state regulation. And third, ''state law is pre-empted to the extent that it actually conflicts with federal law.'' This third form of pre-emption, so-called actual conflict pre-emption, occurs either ''where it is impossible for a private party to comply with both state and federal requirements . . . or where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' '' 120 L. Ed. 2d at 91 (Kennedy, J., concurring; citations omitted). The plurality and dissenting opinions in *Gade* contain essentially the same formulation. *See id.* at 84 and 95, respectively.