

October 4, 2002

Kimberly Bohannon, Assistant Vice President

Regulatory and Compliance Services

North Carolina Credit Union League

4160 Piedmont Parkway

Greensboro, NC 27410

Re: North Carolina Mortgage Lending Act.

Dear Ms. Bohannon:

You have asked if federal credit unions (FCUs) are subject to the provision of North Carolina's Mortgage Lending Act (MLA) that requires financial institutions to file for an exemption from the licensing requirements of the statute. Under the statute, FCUs are subject to a penalty if they fail to file an exemption. Our view is that federal law preempts this state law, and FCUs are not required to comply. We comment below on some other provisions in the MLA, including some we conclude are also preempted.

The MLA establishes a licensing and regulatory framework for entities and natural persons engaged in mortgage lending. It prohibits mortgage lending unless an entity or person is licensed or exempt. FCUs along with other regulated financial institutions are exempt from the licensing requirements and \$500 annual licensing fee of the MLA but are required to file an exemption form. Those that fail to file face a penalty of up to \$250 per year and are prohibited from acting as a mortgage lender or broker. N.C. GEN. STAT. §§53-243.01(8)c, 53-243.15 (2001)(Effective July 1, 2002). The purpose of requiring FCUs to file to obtain an exemption, which is already stated in the statute, is not apparent from the statute or discussions with the state regulator. In addition to requiring exempt entities to file an exemption form, the MLA prohibits them from engaging in a list of prohibited activities. N.C. GEN. STAT. §§53-243.01(8)c, 53-243.11. Most of these activities amount to unfair or deceptive practices that are otherwise illegal or would violate contractual obligations. Two provisions, however, addressing impermissible interest rates and prepayment penalties conflict with federal law and are preempted.

Federal preemption stems from the Supremacy Clause of the United States Constitution, which provides that the laws of the United States shall be the supreme law of the land, notwithstanding any state laws to the contrary. ^[1] Preemption may be express, as when specified in a statute, or it may be implied by the nature of federal legislation and the subject matter, even absent a

declaration of preemptive intent. ^[2] Where Congress' preemptive intent is not expressly stated, it may be inferred on either of two bases: field preemption and conflict preemption. Federal preemption may preempt a state law or statute on the basis of field preemption where the scheme of the federal regulation is "so pervasive as to make reasonable the inference that Congress left no room for States to supplement it." ^[3] Under conflict preemption, a state statute may conflict with federal law to the point "where compliance with both federal and state regulations is a physical impossibility." ^[4] Conflict preemption also occurs when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." ^[5]

FCUs are federal instrumentalities created without relation to state law. 12 U.S.C. §§1751-1795k. When Congress enacted the FCU Act, it contemplated a pervasive system of chartering, regulation, supervision, and examination. Nevertheless, neither the FCU Act nor NCUA's regulations expressly preempt state registration requirements, and the FCU Act and NCUA regulations do not occupy the entire field of credit union regulation. Therefore, federal law does not preempt the North Carolina requirement to file for an exemption on the basis of field preemption.

The FCU Act provides for an FCU's organization and NCUA's approval of the organization certificate, which vests the FCU with its powers and liabilities. 12 U.S.C. §§1753, 1754. The FCU Act does not limit an FCU with respect to its authority to make loans in any state. 12 U.S.C. §1757(5). The FCU Act would, therefore, preempt any state law that required an FCU to obtain a license to engage in mortgage lending. *Id.* The North Carolina law, by requiring FCUs to file for an exemption from a licensing requirement that federal law would preempt, frustrates the objectives of Congress and conflicts with federal law because it interferes with an FCU's ability to make mortgage loans in North Carolina and is in direct conflict with NCUA's exclusive authority in this area.

If an FCU fails to file for an exemption from the MLA, in addition to a penalty, it prohibits an FCU from "transact[ing] business in this State as a mortgage broker." N.C. GEN. STAT. §53-243.01(15)(b). Like a licensing requirement, the requirement that an FCU must file an exemption to make mortgage loans in North Carolina is preempted. It conflicts with federal law because it interferes

with an FCU's ability to make mortgage loans in North Carolina and is in direct conflict with NCUA's exclusive authority in this area.

We have reviewed recent interpretations by the Office of Comptroller of the Currency (OCC) that conclude state requirements that national banks obtain state approvals or licenses to exercise a power authorized under federal law conflict with federal law and are preempted.^[6] The OCC noted that "[i]f a national bank is authorized under federal law to exercise a power, it does not require the additional permission of a state to exercise that power."^[7] This argument is even more compelling with respect to the MLA, because there is no discernable purpose behind the requirement to file the exemption certification.

The statute provides that the state regulator may assess a civil penalty not to exceed \$250 for each year a financial institution fails to file for an exemption. N.C. GEN. STAT. §53-243.15(b). As discussed above, failure to file also prohibits an FCU from acting as a mortgage broker. *Id.* Based on field preemption, if an FCU fails to file its exemption certification, the North Carolina Credit Union Division does not have the authority to enforce the imposition of a civil penalty or prohibit an FCU from making mortgage loans.

The FCU Act contains a pervasive scheme for NCUA examination and supervision of FCUs, including enforcement powers. The FCU Act is so comprehensive in this area as to preclude state action. The FCU Act states that "FCUs shall be under the supervision of the Board" and "[e]ach FCU shall be subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Board." 12 U.S.C. §1756. The FCU Act grants the Board comprehensive examination power over both FCUs and federally-insured state-chartered credit unions (FISCUs). 12 U.S.C. §1754. The Board clearly possesses broad examination and supervision power over FCUs. Under the FCU Act, the Board's authority extends to FISCUs, despite the fact that FISCUs are regulated by states. By contrast, states have no corresponding power to examine FCUs. In recognition of NCUA's exclusive jurisdiction in this area, NCUA's regulations provide that the Board "retains exclusive examination and enforcement jurisdiction over Federal credit unions" and violations of "applicable state laws related to the lending activities of a

Federal credit unions should be referred to the appropriate NCUA regional office.” 12 C.F.R. §701.21(b)(4).

The imposition of any penalty or prohibition under the MLA would fall within NCUA’s exclusive enforcement jurisdiction. Because NCUA is unable to ascertain a rational basis for the requirement to file an exemption and has also determined that the requirement to file is preempted by federal law, NCUA would not be willing to enforce a penalty or take any enforcement action against an FCU that fails to file an exemption.

Finally, we note that the form that credit unions are to use to file for an exemption provides that a credit union agrees to comply with the provisions of the MLA. Thus, the filing of the form is more than registration. The MLA prohibits certain activities for exempted entities that are expressly preempted by the FCU Act. Included in the list of prohibitions is the charging or collecting any fee or rate that is “contrary to the provisions of Chapter 24 of the General Statutes.” N.C. GEN. STAT. §53-243.11(5).

Chapter 24 is preempted to the same extent it was before the enactment of §53-243. N.C. Gen. Stat. Chapter 24. Section 24-1.1E generally tracks the Home Ownership and Equity Protection Act (HOEPA), an amendment to the Truth in Lending Act, 15 U.S.C. §1601 *et seq.*, that covers certain closed-end home loans, and it is not preempted. For those loans not covered by HOEPA, the North Carolina law is preempted, to the extent it limits or affects the rates of interest, finance charges, late charges, closing costs, terms of repayment, and loan conditions, such as the loan amount, type of loan, permissible security, eligibility of borrowers and enforcement of liens. 12 C.F.R. §701.21(b)(1). Although §24-1.1A(b) of the North Carolina statute limits prepayment penalties, they are prohibited under the FCU Act and NCUA’s lending regulation. 12 U.S.C. §1757(5)(A)(viii);12 C.F.R. §701.21(c)(6). Therefore, this provision conflicts with federal law and is preempted.

As explained above, because NCUA has determined that the requirement to file for an exemption is preempted by federal law and the authority to enforce this provision is within NCUA’s exclusive jurisdiction, FCUs are not required to comply with the filing requirements of the MLA.

Sincerely,

Sheila A. Albin

Associate General Counsel

GC/MFR:bhs

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^[1]U.S. Const. art. V, cl. 2.

^[2]Fidelity Savings and Loan Ass’n v. de la Cuesta, 458 U.S. 141, 152-53 (1982); Gade v. National Solid Wastes Management Assoc., 505 U.S. 88, 98 (1992).

^[3]Fidelity Federal, 458 U.S. at 153 (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

[4] Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963).

[5] Gade, 505 U.S. at 98 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

[6] See OCC Interpretive Letters No. 872, dated October 28, 1999, and No. 866, dated October 8, 1999 (preempting state laws that prohibit national banks from engaging in fiduciary activities).

[7] Id. at p. 10.