

Date: February 3, 2000

Payday Lending Operations

OTS can access loan files and business records for transactions that a federal savings bank conducts and can review books and records relating to services provided to the savings bank by a contractor. During a safety and soundness examination, OTS reviews business arrangements with other entities to determine the impact on the thrift's safety and soundness and reviews loans for compliance with safety and soundness standards and established policies and procedures. Federal law gives OTS certain authority over thrift contractors, servicers, and other entities that do business with thrifts.

Subject: Home Owners' Loan Act/Savings Association Powers.

Date: February 3, 2000.

P-2000-4



Office of Thrift Supervision
Department of the Treasury

P-2000-4

Chief Counsel

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

February 3, 2000

[

]

Re: Payday lending operations of []

Dear []:

This responds to your September 30, 1999 inquiry regarding certain lending activities of [Bank], a federal savings bank headquartered in [], New Mexico, and [], doing business in Arizona as [Corporation]. In particular, you raise certain questions about the role of the Office of Thrift Supervision (OTS) in supervising [Bank] and [Corporation] with respect to lending operations involving deferred check presentment agreements, also known as "payday loans." We understand that [Bank] approves and funds such loans, and [Corporation], on [Bank's] behalf, takes applications for and services those loans, subject to various controls established by [Bank].

You indicate that your interest in this matter arises because Arizona law exempts certain entities from state licensing requirements if those entities are regulated by another state or federal agency relating to, *inter alia*, banks, savings banks, and savings and loan associations. Your letter states that you "do not seek an opinion from the OTS as to whether its regulatory role over these transactions is sufficient to meet any exemptions" but rather, you seek information sufficient to allow you "to accurately judge the status of [Bank] and [Corporation]" in Arizona.

We wish to make clear that OTS's regulatory interests regarding [Corporation] are limited to the interactions between [Corporation] and savings associations. We consider the overall regulation and supervision of entities such as [Corporation] to be the responsibility of the states.

By way of background, OTS is examining the issue of payday lending and is considering whether to issue guidance to the thrift industry on potential safety and soundness and consumer protection concerns raised by this activity. We believe that both federal and state regulators

should closely monitor those institutions under their jurisdictions engaged in this type of lending. Our responses to your specifically enumerated questions are set forth below and relate only to the specific relationship between [Corporation] and [Bank] about which you have inquired. Our answers are not intended to address any other transactions between [Corporation] and thrifts other than [Bank].

1. What type of access does the OTS have to the origination, approval, servicing files and other business records for each transaction that occurs in Arizona?

Under Sections 4(a) and 5(a) of the Home Owners' Loan Act (HOLA), OTS has authority to regulate all aspects of the operations of federal savings associations.¹ Pursuant to that regulatory authority, OTS has access to loan files and other business records for every transaction that [Bank] conducts. As stated in Section 5(d)(1)(B)(ii) of the HOLA,² "[i]n the course of any examination of any savings association, upon request by the Director [of OTS], prompt and complete access shall be given . . . to all relevant books, records, or documents of any type." OTS regulations require that a savings association maintain records that will provide an accurate and complete record of all business it transacts and that its records be available at all times for examination and audit "wherever any of those records, documents, files, material, or property may be."³ When, as in the present scenario, a thrift contracts with another entity to perform services that the thrift is authorized to perform under the HOLA, OTS also has the same authority to review the contractor's records, wherever located, relating to the performance of those services.⁴ In addition, pursuant to an agreement between [Bank] and [Corporation], [Bank] has the right to review all books and records relating to [Corporation's] provision of services to [Bank].

2. What type of supervisory review is contemplated for those transactions? (I.e., will samples be taken in connection with each examination? How often will internal controls be reviewed? Will there be compliance reviews of sampled transactions, as opposed to strictly safety and soundness reviews?)

OTS regularly conducts comprehensive safety and soundness examinations of federal savings associations. In addition, OTS has maintained an active, specialized examination program for compliance matters since January 1989.

During a safety and soundness examination, OTS examiners generally look at a thrift's loan underwriting and approval processes and portfolio performance to determine if the thrift's

¹ 12 U.S.C.A. §§ 1463(a) and 1464(a) (West Supp. 1999).

² 12 U.S.C.A. § 1464(d)(1)(B)(ii) (West Supp. 1999).

³ 12 C.F.R. § 563.170(c) (1999).

⁴ 12 U.S.C.A. § 1464(d)(7) (West Supp. 1999).

practices and procedures are safe and sound. In conjunction with the examination, OTS examiners also review business arrangements of a thrift with other entities to determine their impact on the thrift's safety and soundness. OTS examiners focus on the activities of the thrift itself and on whether business operations arising from the thrift's relationship with another entity may adversely impact the thrift. When a thrift contracts with another entity to perform services that the thrift is authorized to perform under the HOLA, OTS may also examine the performance of such services by the other entity.⁵

In the course of an examination, OTS examiners review a sampling of loans for compliance with both safety and soundness standards and the association's established policies and procedures.⁶ The extent of sampling of an association's loans depends on a number of factors, including the level of risk involved and the preliminary findings by the auditors and internal loan review personnel. Examiners may review a select sample from a particular subcategory of thrift assets, *e.g.*, high loan-to-value ratio loans, if the examiners determine that that loan portfolio presents special concerns or risks.⁷ OTS generally reviews an association's overall level of internal controls at each regularly scheduled safety and soundness examination.

OTS also conducts compliance examinations to ascertain the extent and effectiveness of an association's efforts to assure compliance with a host of laws and regulations, including those protecting consumers.⁸ At each compliance examination, OTS examiners review an association's policies and procedures to determine whether they comply with various laws and regulations.⁹ Examiners may also select a sampling of transactions for review. If examiners determine that the association is engaged in a new activity that presents potential risk to it, or if there have been a number of consumer complaints regarding a particular activity of the association, the examiners' review will focus on these areas.¹⁰

⁵ 12 U.S.C.A. § 1464(d)(7) (West Supp. 1999).

⁶ *See, e.g.*, OTS Thrift Activities Regulatory Handbook (TAR Handbook), Section 209, Sampling, at 209.1, 209.3 (September 1995); Section 217, Consumer Lending, at 217.5 (January 1994).

⁷ TAR Handbook, Section 209, Sampling, at 209.2-4 (September 1995).

⁸ These laws and regulations include, for example, the Truth in Lending Act, 15 U.S.C.A. § 1601 *et seq.* (West 1999) and Regulation Z, 12 C.F.R. Part 226 (1999); the Equal Credit Opportunity Act, 15 U.S.C.A. § 1691 *et seq.* (West 1999) and Regulation B, 12 C.F.R. Part 202 (1999); the Fair Housing Act, 42 U.S.C.A. § 3601 *et seq.* (West 1995 & Supp. 1999) and 24 C.F.R. Part 100 *et seq.* (1999); the Real Estate Settlement Procedures Act, 12 U.S.C.A. § 2601 *et seq.* (West 1989 & Supp. 1999) and Regulation X, 24 C.F.R. Part 3500 (1999); and the Home Mortgage Disclosure Act, 12 U.S.C.A. § 2801 *et seq.* (West 1989 & Supp. 1999) and Regulation C, 12 C.F.R. Part 203 (1999).

⁹ Compliance Activities Regulatory Handbook (CAR Handbook), Section 105, Examination Approach, at 105.1 (January 1997).

¹⁰ CAR Handbook, Section 115, Examination Conduct and Control, at 115.4 (January 1997).

3. What is the general examination schedule for [Bank] under normal conditions?

[Bank], like most savings associations, is scheduled for a general safety and soundness examination every 12 months.¹¹ Similarly, like most savings associations, [Bank] is scheduled for a regular compliance examination on a 24- to 36-month interval.¹²

4. What supervisory authority does the OTS have over the [Corporation] entity? (i.e. can the OTS bring any civil or criminal charges against [Corporation]? Can the OTS put [Corporation] into receivership or conservatorship?)

The Examination Parity and Year 2000 Readiness for Financial Institutions Act (Exam Parity Act), which amends the HOLA,¹³ gives OTS some measure of authority over entities that do business with thrifts. If a savings association “causes to be performed for itself, by contract or otherwise, any service” authorized under HOLA, such performance is subject to regulation and examination by OTS “to the same extent as if such services were being performed by the savings association on its own premises. . . .” The Exam Parity Act gives the OTS Director authority to issue regulations and orders pursuant to section 8 of the Federal Deposit Insurance Act (FDIA),¹⁴ as may be necessary to enable the Director to administer the Act. Because of the relationship between [Bank] and [Corporation], [Corporation] may be covered by these provisions.

Section 5 of the HOLA also gives the OTS Director the authority to enforce section 8 of the FDIA, which authorizes OTS to take enforcement action against thrifts and other institution-affiliated parties that the agency believes may be engaging in unsafe and unsound thrift practices.¹⁵ This provision of the FDIA may give OTS jurisdiction to take an administrative enforcement action against [Corporation]. As defined in the FDIA, the term “institution-affiliated party” includes agents.¹⁶ That term also includes independent contractors who “knowingly or recklessly participate in . . . any violation of law or regulation; . . . [or] any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on . . .” the thrift.¹⁷ Because of the contractual relationship between [Corporation] and [Bank] and the types of services being provided by [Corporation] to [Bank], [Corporation]

¹¹ 12 C.F.R. § 563.171(a) (1999).

¹² CAR Handbook, Section 100-2, Overview of the Specialized Compliance Program, at 100-2.1 (January 1997).

¹³ Public Law 105-164, 112 Stat. 32, 33-35 (March 20, 1998), codified at 12 U.S.C.A. § 1464(d)(7) (West Supp. 1999).

¹⁴ 12 U.S.C.A. § 1818 (West 1989 & Supp. 1999).

¹⁵ 12 U.S.C.A. § 1464(d)(1)(A) (West Supp. 1999).

¹⁶ 12 U.S.C.A. § 1813(u)(1) (West 1989 & Supp. 1999).

¹⁷ 12 U.S.C.A. § 1813(u)(4) (West 1989 & Supp. 1999).

might be considered an agent of [Bank]. Depending on how those services are performed and their effect on [Bank], [Corporation] might be covered by the independent contractor provision.

The HOLA does not grant OTS criminal law enforcement authority. OTS refers potential criminal cases to the U.S. Department of Justice or other relevant law enforcement authority. Section 5(d)(2) of the HOLA¹⁸ authorizes OTS to appoint a conservator or receiver for an insured savings association if certain conditions exist, but does not expressly address such authority over service providers.

5. Does the OTS have any power to control [Corporation's] business operations outside of its relationship with [Bank]?

OTS's authority over [Bank's] operations in the [Bank] payday lending scenario, as discussed above, generally is limited to [Corporation's] relationship with [Bank] or another savings association.

6. In cases where consumers seek recourse or resolution to a business dispute in a transaction with [Bank] and [Corporation], will the OTS accept such cases for investigation and resolution?

OTS's consumer complaint process is an adjunct to its supervisory oversight of savings association compliance with federal consumer protection laws. Although OTS does not adjudicate consumer complaints, if OTS receives a complaint against a thrift, it does forward a copy of the complaint to the thrift and obtains a response to a consumer's allegations from the thrift. Where the facts presented disclose an apparent violation of federal regulatory requirements, OTS requires the thrift to correct the condition. This is usually accomplished through informal supervisory action. However, OTS may invoke its formal enforcement powers where necessary to ensure a thrift's compliance with laws and regulations.

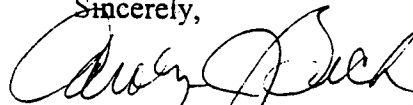
If OTS receives a consumer complaint against [Corporation] based on its relationship with [Bank], OTS follows the same procedure described above. OTS would initially forward a copy of the complaint to [Bank] for a response and, where necessary, for appropriate corrective action. The fact that OTS processes these consumer complaints in this manner does not preclude a state from regulating or pursuing other actions against an entity such as [Corporation] based on its conduct.

We trust these comments are responsive to your questions. We appreciate the opportunity to communicate with you on this matter and hope that such dialogue and coordination will enhance the supervisory process. We wish to reiterate that OTS has only limited jurisdiction over entities such as [Corporation]. Furthermore, in our view, the State of Arizona, as the potential licensor of [Corporation], would have primary responsibility for regulation of that entity. Please

¹⁸ 12 U.S.C.A. § 1464(d)(2) (West Supp. 1999).

feel free to keep us advised about any developments with respect to [Corporation] that you believe would be of interest to this office. If you have any additional questions regarding this matter, please feel free to contact Ellen Sazzman, Counsel (Banking and Finance), at (202) 906-7133, or Vicki Hawkins-Jones, Assistant Chief Counsel, Regulations and Legislation Division, at (202) 906-7034.

Sincerely,



Carolyn J. Buck
Chief Counsel

cc: Frederick R. Casteel, OTS Regional Director (Midwest)

[]