TESTIMONY OF

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BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

HEARINGS ON THE OFFICE OF THE COMPTROLLER OF CURRENCY'S RULES ON NATIONAL BANK PREEMPTION AND VISITORIAL POWERS

APRIL 7, 2004

Introduction

Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, I am North Carolina Attorney General Roy Cooper. Thank you for the opportunity to appear before you to present the views of a state attorney general on the Office of the Comptroller of the Currency's (OCC) recent preemption rules. I would also like to express my appreciation for your interest in this important issue.

The rules on preemption and visitorial powers issued by the OCC in January represent a dramatic change in how we regulate banks that have far-reaching public policy implications. These are not just technical banking regulations. Instead, these rules represent a significant change in the federal-state balance in banking regulation that has served us well for many years. The new rules and the OCC's aggressive preemption campaign raise the following important policy and legal concerns:

- The OCC rules diminish important protections for American consumers.
- The OCC actions undermine creative and effective state efforts to combat predatory lending.
- The OCC regulations ignore congressional intent, damaging states' rights and the legitimate exercise of state powers.

These issues are all of the utmost importance to consumers in my state and across the country and merit congressional scrutiny. As we have been unsuccessful in our efforts to modify the OCC's rules, we now appeal to you.

I presently serve as chair of the Consumer Protection Committee and co-chair of the Predatory Lending Working Group for the National Association of Attorneys General. While I speak only for myself today, I note that all 50 state attorneys general filed joint comments last year expressing opposition to the proposed rules. The attorneys general, like you, represent a rich variety of viewpoints, and it is highly unusual for all of us to agree on anything. However, there is a universal sense of alarm about the OCC's attempt to usurp our ability to protect the people of our respective states, and we are united in our viewpoint.

A copy of the comments by the attorneys general on the OCC's preemption rules is attached to my remarks. Also attached are the comments filed by 45 attorneys general in opposition to the OCC's proposed visitorial powers rules.

In the preemption comments, we characterized the OCC's preemption analysis as one-sided and self-serving. We noted that in recent years, the OCC had embarked on a campaign to preempt state laws and enforcement efforts that have any impact on a national bank's activities. We expressed our desire to cooperate and coordinate enforcement resources with the OCC but also expressed our frustration that the OCC was insisting on an exclusive regulatory system at the expense of consumers.

The proposed rules also were opposed by a number of other organizations representing local leaders, including the National Governors Association, the National Conference of State Legislatures, the Conference of State Banking Supervisors, and the National Association of Consumer Credit Administrators. In addition, many groups representing consumers filed comments opposing the rules, including AARP, the Consumer Federation of America, the Center for Responsible Lending, and the National Community Reinvestment Coalition. These organizations all agreed that the proposed OCC rules were dangerous public policy, were adverse to consumer protection, and exceed the agency's Congressional mandate. Despite this consistent and strong opposition from the states and the public, the OCC went forward with its preemption and visitorial powers rules in much the same form as proposed. I believe these rules go far beyond the intent of Congress and that states, on behalf of American consumers, would ultimately win in court. I do not believe that these rules comply with the law, and I will fight them. However, the best way to deal with this problem is for Congress to step forward, which is why I am here today.

In these remarks, I will provide a brief description of the rules, discuss some of the OCC's stated justifications for the rules, and then highlight three major policy and legal critiques of these rules.

The OCC's Preemption and Visitorial Powers Rules

In its recent rules on preemption and visitorial powers, the OCC has attempted to eliminate any substantive role for states in regulating activities of national banks. The preemption rule broadly preempts state laws that "obstruct, impair or condition" the exercise of a bank's authority. In the OCC's view, it is difficult to find any state-based consumer protections that do not impermissibly obstruct a bank. According to the OCC, state laws apply to national banks only to the extent that they "incidentally" affect national bank activities. To the OCC, "incidental" refers to only three types of state laws: those state laws that are helpful to banks, such as contract laws, because they "establish the legal infrastructure" for the conduct of business; those laws that the courts have specifically held to be applicable to banks, including fair lending and debt collection laws;[1] and those laws that represent miscellaneous and general government regulation, such as zoning and fire safety ordinances. The OCC would argue that under its rules all other state laws would have no effect on national banks and their operating subsidiaries.

The visitorial powers rule essentially declares that only the OCC can enforce federal and state laws that apply to national banks and their operating subsidiaries. "Visitorial powers," despite the

[1] See National State Bank, Elizabeth, NJ v. Long, 630 F.2d 981 (1980); First National Bank v. Commonwealth of Kentucky, 76 US (9 Wall) 353, 362; 19 L.Ed 701, 703 (1870).

OCC's attempt to expansively define the term, is simply the authority to conduct administrative examinations of national banks primarily to ensure safety and soundness.[2] It does not and should not be stretched to include civil actions by attorneys general to enforce laws of general applicability against national banks. Yet, under the OCC's new rule, the OCC would contend that state attorneys general cannot bring enforcement actions against national banks for violations of consumer protection laws of general application, even when those violations do not involve core banking activities.

Finally, the OCC has extended the full coverage of its preemption and visitorial powers rulings not only to nationally chartered banks but to all operating subsidiaries of those banks. This development is particularly troubling since these entities are more likely to engage in predatory lending and less likely to be closely supervised by the OCC. Operating subsidiaries are non-bank, state-chartered corporations that are creatures of state law. Furthermore, nowhere does the National Bank Act refer to operating subsidiaries.

Such operating subsidiaries could include mortgage companies which are partially owned by a subsidiary of another subsidiary of a bank, three steps away from the bank. In many states, these mortgage companies have been licensed and regulated by state banking supervisors for many years without controversy. Now, by administrative fiat from the OCC, these entities are purportedly free of state supervision and free of a longstanding obligation to comply with state regulatory laws. It is unclear to what extent the OCC will also extend preemption coverage to third party agents who may solicit or originate loans for national banks, but the OCC's prior actions cause concern that its preemption sweep could be wide. For example, in 2001, the OCC determined that Michigan's motor vehicle sales financing laws did not apply to a dealer who was arranging car loans for an out-of-state national bank.[3]

THE OCC'S JUSTIFICATIONS

The OCC states that it is adopting these rules to enable banks to operate under consistent, uniform national standards administered by the OCC so that they can operate more efficiently. Yet, the tradeoff in loss of important consumer protections and enforcement far outweighs any perceived efficiency gains that preemption may provide.

Our republic is federal, and it values local control, particularly in matters involving the health, safety, and welfare of its citizens. Local control is especially appropriate in the area of real estate lending. Mortgage lending implicates local property law, local loan closing standards, and local recordation requirements. Damage resulting from predatory lending affects the local community. Banks are sophisticated and resourceful enterprises. They have been complying with state laws of general application since their inception and can continue to do so.

The OCC implies that the states are putting undue burdens on national banks. It has adopted a view that state laws and state enforcement hinder legitimate bank activity. This is not the case. I am proud of the national banks located within North Carolina; they are leaders in their fields. None of the

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[2] See, Section IIIA of the attached Comments and Recommendations of the Attorneys General in response to NPRM of February 7, 2003 concerning the reinterpretation of the visitorial powers rule.

[3] <u>May 23, 2001 Interpretative Letter</u>, 66 Fed. Reg. 28593 (5/23/01) (declaring that a car dealer in Michigan is not subject to state motor vehicle sales financing laws if a national bank is financing the sale).

national banks across the country has been handcuffed by unreasonable state restrictions, and they do not need the OCC to insulate them from obligations to be good corporate citizens in the states.

Furthermore, I note from personal experience that North Carolina's banking industry was an important part of the negotiations to develop North Carolina's predatory lending law from beginning to end. Their support of our new law, which was the first in the nation to comprehensively address predatory lending, was critical to its success.

In all these areas highlighted in the recent rules – preemption of state laws, preemption of state enforcement, and preemption for non-bank subsidiaries – the OCC claims that it is merely exercising longstanding powers and codifying existing law. This characterization is wrong. The OCC's actions are recent in origin and far reaching in scope. Even though much of this body of law is decades old, the OCC has pushed its aggressive interpretation only within the last few years. These new rules, together with other OCC actions in recent years, leave little doubt that the OCC intends to override the historic role of the states to protect consumers.

The OCC has been explicit about trying to entice federal thrifts and state banks to switch their charters to that of a national bank. Eliminating any role for the states is evidently a selling point in their competition with other regulators. The Comptroller recently touted the benefits of a national bank charter in a speech:

> "The ability of a national bank to conduct a multistate business subject to a *single* uniform set of federal laws, under the supervision of a *single* regulator, *free* from the visitorial powers of various state authorities, is a major advantage of the national charter …"[4] [italics added]

The Comptroller told the Wall Street Journal, "[The power of the OCC to override state law] is one of the advantages of a national charter, and I'm not the least bit ashamed to promote it."[5] An article in a recent American Banker recounted a trip the Comptroller took to Tennessee to recruit a bank to maintain its national charter, as if he were a basketball coach traveling the country trying to recruit players to his team.[6] The notion of a regulator, particularly one who oversees an organization funded by membership fees, trying to recruit its regulated entities, while using the enticement of preemption of state law and state enforcement, fails to promote confidence in our system of government or in the OCC's objectivity in creating these rules.

The OCC's Preemption Rules Diminish Consumer Protections by Taking Cops Off The Beat

We have a profound disagreement with the OCC about whether its legal authority permits it to pursue its aggressive preemption policies, and I will address its misinterpretation of congressional intent and Supreme Court precedent in a later section. However, whether or not the OCC can justify its actions as a matter of administrative law, the wholesale preemption in the OCC rules is wrong as a matter of public policy.

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[4] OCC News Release 2002-10.
[5] Beckett, Paul and Jess Bravin, "Dependent on Lenders' Fees, the OCC takes Banks' Side Against Local Laws," Wall Street Journal, 1/28/02.
[6] Linder, Craig, "JPM-Bank One: How It Might Hit Regulators," American Banker, 1/27/04, p. 1.

The new OCC rules upset the legal structure that has positively served both the banking industry and the consuming public for many years. Consumer protection benefits not only consumers, but also competitors that play by the rules. Until the OCC embarked on this preemption campaign, state and federal regulators coexisted well. Most state consumer protection laws, with the notable exception of usury laws, were applied to national banks without controversy and numerous enforcement actions occurred without either the affected bank or the OCC asserting preemption of state law or enforcement.[7] State attorneys general have handled and mediated consumer complaints against national banks and have formally and informally resolved consumer protection issues with those banks for decades.

Simply put, the OCC rules will eliminate 50 cops from the beat. These are cops who not only protect consumers, but who help resolve conflicts between consumers and businesses, often in an amicable way. One would hope that the OCC would be seeking to partner with the states in protecting consumers and solving their problems. I believe that the state attorneys general and the OCC share common goals of eliminating unfair and deceptive practices and in assuring a fair and competitive credit marketplace. So it would be far preferable if we acted to complement each other's efforts because there is more than enough work for us all. Consumers need more consumer advocates to enforce the law, not fewer.

The attorneys general have worked well with the Federal Trade Commission (FTC) and other federal agencies in exercising our dual enforcement authority in other areas. I believe that the nation and our financial markets are much better off today because the Securities and Exchange Commission's enforcement authority is not exclusive.

The new rules do more than attempt to eliminate state enforcement; they also attempt to end private rights of action against banks. Under North Carolina law, private individuals have a right to vindicate their claims against national banks in state courts under our state unfair and deceptive trade practice and predatory lending laws. Since, according to the OCC, these laws no longer apply to national banks, the OCC's actions strip consumers of their right to seek redress and offer them no recourse in return because the FTC Act effectively allows no private right of action. It is a basic premise of law enforcement that effective enforcement creates deterrence. By attempting to eliminate both state and private enforcement, the OCC is undercutting the deterrent effect of consumer protection laws.

I compliment the OCC for issuing Advisory Letter 2004-2 in February. Prior to its issuance, the OCC had interpreted its visitorial powers so expansively as to permit national banks to ignore state attorneys general and banking commissioners even when we were processing routine consumer complaints.[8] In its exuberance to shield national banks from the states, the OCC was prepared to

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[7] See, e.g., State of Alaska v. First National Bank of Anchorage, 660 P.2d 406 (Alaska 1982) (holding that the Alaska Attorney General could sue a national bank); Attorney General v. Michigan Nat'l Bank, 312 N.W.2d 405, 414 (Mich. App. 1981), overruled on other grounds 325 N.W.2d 777 (Mich. 1982) (holding that a national bank could be held liable by the Attorney General under state and federal consumer protection laws related to mortgage escrow accounts); State of Arizona v. Sgrillo and Valley National Bank of Arizona, 176 Ariz. 148, 859 P.2d 771 (1993); State of Wisconsin v. Ameritech Corp., Household Bank and Household Credit Services, 185 Wis. 2d 686, 517 N.W.2d 705 (1994), aff'd 532 N.W.2d 449 (Wisc. 1995); State of West Virginia v. Scott Runyan Pontiac-Buick, Citizens National Bank, et al., 194 W.Va. 770, 461 S.E.2d 516 (W.Va. 1995) (holding that the Attorney General had the right to bring a civil action against the financial institutions, including the national bank); State of Minnesota v. U.S. Bancorp., Inc., Case No. 99-872 (Consent Judgment, D. Minn. 1999).

[8] OCC Advisory Letter 2002-9, 11/25/02.

sacrifice the efficient mediation of consumer complaints. Fortunately, congressional and public pressure has forced it to reconsider.

Over the past two years, my office alone has handled approximately 1,000 formal, written complaints from North Carolina consumers against national banks and their identifiable operating subsidiaries and thousands more telephone calls. By extrapolation, offices of attorneys general across the nation receive approximately 20,000 written complaints each year concerning national banks and their operating subsidiaries and tens of thousands more telephone inquiries. These complaints, for the most part, are routine and, until last year, had been resolved by the banks without controversy and without objection from the OCC.

While I commend this recent Advisory Letter, it fails to answer all our concerns. The OCC remains clear in its instruction to banks that if a state does more than simply forward a complaint, then the bank is to refuse to cooperate and to let the OCC know of the state's actions. If my office were to get a number of complaints against an operating subsidiary of a national bank and we wanted to investigate the matter to ensure that no laws were being broken, the OCC has taken the extraordinary step of instructing its member institutions to immediately notify the OCC and to refuse to cooperate with my investigation. In fact, the OCC has halted numerous investigations and lawsuits by various state attorneys general in the last three years.[9] This is wrong.

This outcome could leave me and my colleagues in the unenviable position of suspecting a wrong but being unable to help the consumer who needs it unless the courts decide otherwise. My office receives more than 100,000 phone calls and 17,000 written complaints each year, and credit issues are the number one source of complaints for the past three years. Across the nation, hundreds of lawyers and hundreds more consumer protection specialists, investigators and support staff work on consumer protection matters. Thousands of staffers working for state banking supervisors presently regulate many operating subsidiaries of national banks. There is never a shortage of work because the need is great.

That work has paid off for consumers. In 2001, my office settled predatory lending allegations against The Associates resulting in $20 million in consumer restitution to North Carolinians. A year later the FTC achieved a national settlement with the same entity for $215 million. This case provides an excellent example of state/federal cooperation. North Carolina and the FTC initiated separate investigations into The Associates' lending practices, and consulted with each other regularly. I believe that once North Carolina achieved its result, it established a consumer friendly framework for the FTC and the nation. Instead of competing over jurisdiction, we complemented each other's efforts, and most importantly, protected consumers.

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[9] See section C in the attached comments by state attorneys general on the preemption rule. See, also, e.g., State of Minnesota v. Fleet Mortgage Corp., 158 F. Supp. 2d 962 (D. Minn. 2001) (involving unfair and deceptive sales practices and telemarketing); In the matters of Citibank and FirstUSA (involving an investigation begun in 2001 by Florida, Illinois, California, and New York into the telemarketing operations of national banks in which the OCC unsuccessfully sought to dissuade banks from concluding settlements with the states); In the matter of Citibank, US Bank, et. al. (involving an investigation of on-line gambling by New York); In the matter of Key National Bank (involving an investigation by Maryland, Missouri, and Illinois into student loans in which the OCC claimed it alone would make a determination of liability and after issuing its recent regulations, the OCC notified the Illinois Attorney General's office that it would not pursue the case against Key).

I was also fortunate to have participated in a multistate predatory lending settlement with Household that provided $484 million in restitution to consumers across the nation, $11 million for North Carolina residents alone. Clearly, the states have valuable experience in consumer protection broadly and combating predatory lending specifically.

By contrast, the OCC's primary mission is to ensure the safety and soundness of the national banking system. While that mission is vital, the OCC's consumer protection role has been, at best, a secondary development. It was not until 2000 that the OCC determined it had the authority to apply the unfair and deceptive trade practices standards in the FTC Act against national banks. In a published article, the First Senior Deputy Comptroller of the OCC questioned "why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act."[10] While the OCC was deliberating whether it had authority to protect consumers, states have been enforcing state unfair practices laws for many years against a wide variety of business entities.[11]

Furthermore, the administrative enforcement actions undertaken by the OCC have had limited success in obtaining restitution for consumers who have been victimized by unfair banking practices. My office identified only one OCC case involving home mortgage abuses that provided restitution; it restored $100,000 to 30 people.[12] While we welcome the OCC's recent administrative efforts at consumer protection, those efforts cannot supplant the efforts and achievements that the states have and can achieve on behalf of consumers through negotiation and litigation. I have serious concerns that the OCC will be unable to pursue all cases that should be brought nor achieve adequate results in all those cases they do bring.

This skepticism regarding the OCC's commitment to consumer protection also grows from an examination of the role it has played in recent years in disputes between consumers and national banks. The OCC has been criticized for consistently siding with national banks in cases brought by consumers.[13] As The Wall Street Journal stated in an article entitled "Dependent on Lenders' Fees, the OCC Takes Banks' Side Against Local Laws":[14]

> "Many federal regulators have a clear mandate to put consumers first… It's less clear-cut for the federal banking watchdog. Time and again, the U.S. agency that bank customers might assume is on their side has lined up with banks to fight state and local measures that purport to aid consumers.

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[10] Williams, Julie L. and Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Lawyer 1243, 1244 (May, 2003).
[11] See note 7 for a partial list of cases.
[12] See 69 Fed. Reg. 1904, 1913 (Jan. 13, 2004*)*. In the Matter of Clear Lake National Bank, San Antonio, Tx, Enforcement Action 2003-135 (November 6, 2003).
[13] See, e.g., Bank One, Utah v. Guttau, 1998 U.S. Dist. Lexis 14830 (S.D. Iowa, 1998) (siding with bank against Iowa statute that required ATMs to display name, address and phone number of owner and to maintain a state office); Metrobank v. Foster, 193 F. Supp.2d 1156 (S.D. Iowa 2002) (supporting a national bank in opposing Iowa's prohibition against charging ATM fees that exceed "interchange fees"); Wells Fargo v. James, 321 F.3d 488 (5th Cir. 2003) (supporting group of banks opposed to Texas' "par value" statute that prohibits a bank from charging fees to cash checks drawn on that bank); May 10, 2001 Interpretative Letter, 66 Fed. Reg. 23977 (5/10/01) (authorizing national banks to conduct sales of returned lease vehicles without complying with Ohio sales licensing laws); May 23, 2001 Interpretative Letter, 66 Fed. Reg. 28593 (5/23/01) (declaring that a car dealer in Michigan is not subject to state motor vehicle sales financing laws if a national bank is financing the sale).
[14] See note 5.

> "... The OCC's siding with banks in court fights 'may operate in some cases to the disadvantage of consumers,' says [Comptroller] Hawke, a 68-year old lawyer who in private practice represented both state and federally chartered banks. But his agency 'can't pick and choose whether a state law or action is good or bad' for consumers. If it cramps banks' freedom to operate in the eyes of the OCC, it must go, he says."

The article goes on to note the OCC's built-in conflict of interest. It competes for the loyalty of its banking constituency and seeks out new banks to convert to a national charter. This "solicitousness toward the businesses it oversees," in the words of the Journal, fails to encourage confidence in the OCC's consumer protection function.

I do not maintain that the OCC has undertaken its groundbreaking interpretation of federal law because it doesn't care about its member institutions that may engage in predatory lending or other violations of state law. I believe it certainly wants to see its banks obeying the law. Yet, by preempting state consumer protection laws and attempting to eliminate any real role for state and private enforcement of those laws, I am certain that the OCC is doing harm to American banking customers. It simply is not good public policy to leave all consumer protection enforcement exclusively in the hands of a single agency that does not possess infinite resources nor share the same history and culture of protecting consumers as state attorneys general.

The OCC Rules Do Not Effectively Address the Problem of Predatory Mortgage Lending and They Undermine State Initiatives to Eliminate Predatory Lending Abuses

The OCC's preemption rules will undermine the actions of many states to attack the critical problem of predatory mortgage lending while offering up no effective alternative regulatory scheme. The OCC has preempted virtually every consumer protection provision in the Georgia Fair Lending Act and leaves no room for states to exercise their proper role to protect their residents from abusive practices. It appears that the OCC does not understand the seriousness of this problem, because it regards state predatory lending laws as impediments to efficient interstate bank operations, not as vital protections for consumers.

The states have taken effective action to curtail predatory lending, both by enacting and enforcing laws. The OCC, instead of recognizing and emulating the efforts of the states, has criticized them while failing to implement effective regulations of its own. The predatory lending provisions in the OCC rules are minimal and fail to address most of the abusive practices identified in state laws. The OCC has identified and addressed only one specific abuse – asset-based lending. It also indicates that it will apply the FTC Act's unfair and deceptive standards to the area of mortgage lending but does not identify what activities might constitute unfair and deceptive practices.

Almost all states have mini-FTC Acts, but a growing number of states have concluded that predatory lending is better addressed by targeted laws that attack specific abuses. These new state laws address a number of specific problems absent in the OCC's rules, including unjustified origination fees, deceptive "discount" points, excessive prepayment penalties, loan flipping, and the financing of single premium credit insurance. Just last week, a number of subprime lending industry representatives testified before two House subcommittees that they endorse a federal predatory lending law, but only if it has clear rules, not general guidelines that require interpretation. Unfortunately this is what the OCC has chosen to do.

Of particular concern is that the OCC believes that predatory lending laws seriously interfere with a national bank's ability to make loans. When I was a state senator, I sponsored North Carolina's predatory lending law in 1999. I can assure you that both state and federally chartered banks in North Carolina, to their credit, recognized the devastating effects of predatory lending and actively supported our legislation. I do not believe they will say that the guidelines and protections in our law would have any significant impact on a bank's real estate lending. In drafting the legislation, we were careful to target abusive practices that reputable lenders do not engage in and to avoid imposing burdens on the legitimate mortgage lending marketplace. We were also careful, under the prevailing legal wisdom of the time, to make the legislation preemption-proof by emphasizing consumer protections and avoiding limits on interest rates or fees. That was 1999, though, before the OCC changed the rules. Now all state predatory lending laws and their consumer protections are at risk of being wiped out by the OCC's preemption rule.

North Carolina's law has worked. The worst predatory lending practices have been stopped; yet subprime mortgage credit remains freely available to North Carolina consumers. A comprehensive study published last year by the Kenan-Flagler School of Business at the University of North Carolina came to the following conclusion:

> "The study shows that since the North Carolina law went into full effect, the subprime market has behaved just as the law intended … The number of loans with predatory characteristics has fallen without either restricting access to loans to borrowers with blemished credit or increasing the cost of those loans."[15]

Another study showed that our law saved consumers $100 million in the first year alone.[16]

Many of the reforms implemented by North Carolina's predatory lending law have been voluntarily adopted as "best practices" by national subprime lenders. The prohibition on selling single premium credit insurance was considered controversial when we enacted it into law in 2000. Yet within two years, all the major subprime lenders have ceased offering this overpriced product. North Carolina enacted a prohibition on loan flipping and required that refinanced loans offer some "net tangible benefit" for the borrower. Now we see lenders implementing their own similar net tangible benefit tests on a national basis. Also, subprime lenders like CitiFinancial, Household and Wells Fargo Financial have reduced their origination fees and prepayment penalties, which were two of the practices targeted by North Carolina's law. I have met with executives from two of the nation's largest subprime mortgage companies, and they informed me that our law is reasonable and has weeded out the most abusive lenders without restricting their companies' ability to extend credit.

The OCC takes a different view. In its efforts to shelter national banks from state predatory lending laws, the OCC has sought to discredit these laws as applied to all lenders, not only national

[15] Quercia, R.G., M.A. Stegman, and W.R. Davis, "The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment," Kenan-Flagler Business School, UNC-Chapel Hill, June 25, 2003.
[16] Ernst, Keith, John Farris, and Eric Stein, "North Carolina's Subprime Home Loan Market After Predatory Lending Reform," Center for Responsible Lending, August 2002.

banks. The OCC has criticized the North Carolina law and has published a flawed report to attempt to discredit both our law and the UNC study.[17] Its claim that predatory lending laws in general and the Georgia law in particular interfere significantly with lenders' ability to make real estate loans is off the mark. The Center for Responsible Lending has published an excellent critique of the OCC's Working Paper.[18]

If the OCC has objections to any particular provisions of these state laws, it should address those concerns specifically instead of issuing blanket orders that preempt all state laws. North Carolina law has been in effect for three and a half years, and it is working.

There has been a great deal of misunderstanding about the effects of predatory lending laws. The First Senior Deputy Comptroller of the OCC testified in January before the House Committee on Financial Services about high cost loans requiring additional scrutiny by the marketplace.[19] She makes a flawed assumption that extra scrutiny by the marketplace of high cost loans is bad. One must distinguish between subprime loans and high cost loans. High cost loans represent a subset of subprime loans, those with the highest percentage of points and fees. The extra scrutiny described is reserved for only high cost loans, not all subprime loans. There are few if any high cost loans made, and when made, they may be contrary to the borrower's interests. For this reason, North Carolina law places extra burdens on high cost loans. It is appropriate for the marketplace to scrutinize these loans to make sure they are legitimate, not predatory.

I am concerned that these rules could have the unintended result of fostering predatory lending. The changes make a national bank charter attractive to unscrupulous, as well as scrupulous, lenders. There are 2,500 national banks,[20] and if these rules achieve the desired effect of increasing membership, this number will grow. National banks have an unknown number of operating subsidiaries and operating subsidiary joint ventures. Wells Fargo alone had 76 operating subsidiaries that engaged in consumer mortgage lending in May, 2002.[21] The OCC cannot guarantee that it will prevent operating subsidiaries and their multiple joint ventures from engaging in predatory lending, especially when it fails to define predatory lending with any specificity and when it has reduced the deterrent for engaging in predatory lending by eliminating state and private enforcement.

Congressional Intent and Court Precedent Support the Applicability of Many State Laws to National Banks

There is ample precedent to support the proposition that national banks are subject to certain state laws and a dual system of enforcement. The attorneys general summarized the legal precedent in our attached comments to the proposed preemption rules, and I will not restate the full legal analysis here. In summary, it is the position of all fifty states that the OCC, in its pursuit of preemption authority, has not fairly analyzed the cases governing the legal standard for preemption.

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[17] See, OCC Working Paper, Economic Issues in Predatory Lending, July 30, 2003.
[18] See, Center for Responsible Lending, Comments on the OCC Working Paper, September 2003.
[19] See, Testimony of Julie Williams before Subcommittee on Oversight and Investigations, January 28, 2004.
[20] OCC website: www.occ.treas.gov.
[21] Testimony of Hilary Shelton, House Committee on Financial Services, Subcommittee on Oversight and Investigations, 1/28/04.

I will note that the leading Supreme Court case on national bank preemption, Barnett Bank of Marion County, N.A. v. Nelson,[22] establishes a test of whether state law imposes a "significant impairment" or "significant interference" with a bank's rights under federal law. The Court said that preemption would be found if there was a direct conflict with express federal statutory authority because "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted." (emphasis added). The Court went on to say that the preemption test was not intended "to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers."

The Supreme Court, in Barnett and in many other cases, has not divested the states of all meaningful regulatory authority over national banks, as the OCC essentially maintains. These decisions leave a substantial role for the states. If a state law discriminates against a national bank, prohibits it from doing business, or significantly interferes with its operations, then we agree there is preemption. The rub is what "significant" means. The OCC believes any limitation or restriction imposed by a state, however slight, constitutes significant interference if it "obstructs, impairs, or conditions" a national bank. Under the OCC's theory, state consumer protection laws would be preempted, since most such laws impose some compliance requirement and have some incidental impact on a bank's efficiency.

An example of the OCC's extreme construction of these preemption standards can be found in its August 2003 order preempting the Georgia Fair Lending Act.[23] The Georgia law prohibits lenders from encouraging prospective borrowers to default on their existing mortgage loans. North Carolina's law has a similar provision. Soliciting default would seem to be an obvious unfair trade practice, and I do not believe any reputable lender or bank would ever engage in it. The prohibition, therefore, does not impose any particular burdens on a bank. Yet the OCC declared this uncontroversial provision to be preempted because it imposed an impermissible restriction on, and interfered with, "the exercise of the Federal power of national banks to make real estate loans."

In creating its new preemption standard, the OCC ignores Congressional intent and misinterprets Supreme Court precedent. Congress expressed its particular concerns about banking preemption by the OCC in the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act.[24] In enacting that law, Congress stated that state law would continue to apply to the interstate operations of national banks, particularly in the area of consumer protection. The report of the House-Senate conference committee noted that under "well established judicial principles, national banks are subject to state law in many significant respects." The Conference Report found that, in the area of banking, the states have a legitimate interest in protecting the rights of their consumers. The Report then declared that "Congress does not intend that the [Act] alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities."[25]

The Riegle-Neal Act is a clear expression of Congressional intent as to the importance of the consumer protection role of the states. However, the OCC tries to avoid Riegle-Neal's direction by contending that the language on applicability of state laws does not apply to laws preempted by federal law. The OCC does not acknowledge that in 1994, it was generally accepted that state consumer

[22] 517 U.S. 25 (1996).
[23] 68 FR 46264 (Aug. 5, 2003).
[24] Pub. L. 103-328.
[25] H.R. Rep. No. 103-651, 1994 U.S. Code Cong. & Ad. News 2068, 2074.

protection laws were not preempted. Congress would have had no reason in 1994 to anticipate that its legislative intent would be thwarted by the OCC declaring all state consumer protection laws to be preempted.

Congress has affirmed the longstanding consumer protection role of the states in the area of banking. However, the OCC has ignored this Congressional mandate and has attempted to erase the protections afforded American consumers from their state laws and state enforcement officials. My fellow attorneys general and I understand the Supremacy Clause. If our elected representatives in Congress speak, we honor it. But it is unacceptable for the OCC to make these important policy decisions overriding state law to the detriment of consumers.

Conclusion

The state attorneys general would prefer to have a cooperative relationship with the OCC, as we do with other federal agencies. We should be sharing resources and working toward common goals of consumer protection and fair competition. Unfortunately, in its preemption rules and other recent actions, the OCC position will block consumers from experts who can help them. In the name of banking efficiency, the OCC has swept aside state consumer protection laws and the ability of state enforcement authorities to investigate and seek remedies for unlawful practices of both national banks and their operating subsidiaries.

The opposition expressed by all states to the OCC's actions is unprecedented but to date, we have had no apparent impact on the OCC's push toward preemption. All 50 state attorneys general believe that the OCC's rules are wrong as a matter of law and as a matter of policy. We will continue to assert our state enforcement rights in every forum available to us, including the courts, but when a federal agency acts beyond the authority Congress has granted it and alters core principles of federalism, states' rights, and consumer protection in the process, we believe that a congressional correction is necessary.

My fellow attorneys general and I appreciate the Committee's interest in these important issues.