Testimony of

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For the

STATE OF IDAHO

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

Before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

April 7, 2004

Good morning Chairman Shelby, Senator Sarbanes and members of the Committee. I am Gavin Gee, Director of Finance for the State of Idaho and am here today testifying on behalf of the Conference of State Bank Supervisors (CSBS).

I thank you for inviting CSBS here today to discuss our concerns about the Comptroller of the Currency's recent preemption of state consumer protection laws and enforcement authority. We commend you on this important and timely hearing, and we especially appreciate this opportunity to represent state banking regulators' views on the interplay of state and federal laws that govern banks and their operating subsidiaries.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's approximately 6,200 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

What may be more important to this discussion of preemption, however, is that, by and large, we are the same state officials who license, examine, and take consumer complaints and enforcement actions against some types of entities that are, or could become operating subsidiaries of national banks. I am referring to mortgage brokers, mortgage lenders, finance companies, and other non-depository lending institutions.

The Comptroller of the Currency's recent regulations seek to preempt almost all state laws that apply to these businesses, if they are operating subsidiaries of national banks. This regulation also tries to shield all national banks – and their operating subsidiaries – from oversight, inspection and enforcement actions by any state authority, including the state attorneys general.

The Comptroller has said repeatedly that these new regulations present no fundamental shift in the OCC's roles or responsibilities. He has called these regulations merely the next logical step in the OCC's interpretation of the National Bank Act, the Riegle-Neal Interstate Banking and Branching Efficiency Act, and the Gramm-Leach-Bliley Act. The Comptroller has also said that these changes are incremental in nature and unlikely to have major effects on the banking industry or on consumers' experiences with financial institutions.

Chairman Shelby, members of the Committee, these claims – however often they may be repeated – are not true. These regulations are not minor or incremental changes. Their scope is nearly unlimited, and their implications are potentially enormous. These regulations exceed the OCC's statutory authority and disregard Congressional intent. They effectively discard the oversight and consumer protection structure already in place for these businesses, and they ignore Congress's design for functional regulation.

The OCC adopted these regulations over the strong objections from CSBS, the National Governors Association, the National Conference of State Legislatures and all fifty state attorneys general. The OCC also ignored requests from members of Congress for extra time to consider the implications of these new rules. Instead, the OCC issued a set of regulations that may affect millions of consumers across the country without a public hearing and without meaningful consultation with the parties these regulations would affect. We object strongly to the OCC's process in issuing these regulations, and we look forward to the findings of the General Accounting Office's study of this process.

Technology is changing the delivery of financial products. Many large banks and some small banks look less like the old commercial bank and more like the diversified financial services providers envisioned by the Gramm-Leach-Bliley Act. We appreciate that the largest financial services providers want more coordinated regulation that helps them create a nationwide financial marketplace. These goals are understandable. The state of Idaho and CSBS support coordinated regulation in order to promote modernization of financial services, healthy competition among providers, and greater availability of financial services to the public.

The Comptroller's stealth plan to cater to these desires, however, is not easily understandable, nor is it reasonable. The OCC's new regulations usurp the powers of Congress, stifle states' efforts to protect their citizens, and threaten not only the dual banking system but also public confidence in our financial services industry. They challenge the functional regulatory structure created by Gramm-Leach-Bliley and set the Office of the Comptroller of the Currency as the nation's dominant regulator of financial institutions and their state-corporate subsidiaries.

We salute the Committee for holding this important hearing, and for expressing appropriate concern about this regulation.

State laws against predatory lending seem to be the impetus of these regulations. I understand the objections some companies have to some of the laws states have enacted. But legislative processes exist to change these laws, if necessary. Circumventing the legislative process is not the right way to change a law. Issuing regulations in an apparent attempt at empire building, sweeping away the work of thousands of state legislators to protect millions of consumers, is absolutely wrong. The Comptroller's actions affect not only predatory lending laws, but all state consumer protection laws and the states' enforcement of those laws.

To justify its rush to finalize its preemption rules, the OCC has stated that its rules are necessary to prevent "real world" interference with credit availability resulting from state predatory lending laws. Idaho, like the majority of states, has not passed specific predatory lending legislation. There has been no interference with credit availability in our "real world" of Idaho. Yet the result has been that every state's consumer protection laws and enforcement have been preempted.

We can tell you, and I am sure that the OCC can confirm, that the worst cases of predatory lending we see come from nonbank lenders. Many of these state-licensed businesses are now considering becoming operating subsidiaries of national banks in order to exempt themselves from state laws. A coordinated structure exists at the state level to supervise these entities, often involving multiple agencies. We do not believe that the OCC has any system in place that would offer a comparable level of oversight.

If you allow these OCC rules to stand, our banking system, bank customers, and customers of mortgage brokers, mortgage lenders, finance companies, and other non-depository lending companies that become operating subsidiaries of national banks will be hurt.

We are already seeing state-licensed entities converting to the national bank operating subsidiary structure. The most dramatic recent example is HSBC's announcement of its intent to convert to a national bank charter. HSBC is the parent corporation of Household International, one of the nation's largest mortgage and consumer finance companies. Household is now subject to a variety of state licensing and consumer protection laws. In 2002, due to charges of unfair and deceptive practices, Household reached a record settlement of $484 million in consumer restitution and agreed to changes in it practices with all fifty states. Once its parent, HSBC, is a national bank, Household can become an operating subsidiary of that national bank, and its customers will lose all the protections they now have under state law. To its credit, HSBC has said that it plans to maintain Household HFC as a state-licensed entity, but the Comptroller's regulations offer a powerful incentive to make that change.

As the Idaho Director of Finance, I care deeply about Idaho consumers. I care about protecting them from lending abuses, and about having legitimate credit choices available to them. Our Department's mission statement is: "To aggressively promote access to vigorous, healthy and comprehensive financial services for Idaho citizens. This is accomplished through prudent and efficient oversight of financial institutions, investment opportunities, and credit transactions. Through laws enacted by the Idaho Legislature, legitimate financial transactions are encouraged, while fraud, unsafe practices, and unlawful conduct are detected and appropriate enforcement action is taken."

There is no reason to believe that the OCC cares more than I, my Department, our Governor, or Idaho's legislature, do about Idaho's consumers and promoting financial services in Idaho. That is why I am asking Congress to turn this preemption effort aside.

Representatives of the OCC have spoken lately at length about cooperation. We want to assure this Committee that the states have a long history of cooperation and coordination with federal regulatory agencies. Idaho and other states have, for example, entered cooperative agreements with the FDIC and the Federal Reserve System to govern our joint supervision of banks. But this cooperation stems from mutual respect for each other's abilities and authority. It appears to the states that the OCC is attempting to disguise its demands for acquiescence as pleas for cooperation. After endeavoring to eliminate our ability to protect our citizens in this regard, the OCC wonders why we can't just get along.

We urge this Committee and the Congress to reassert their authority in this area. It remains Congress's responsibility to set the policy that bank regulators implement. Congress has already laid out a framework for the interaction of state and federal banking laws; the OCC's regulations would make that framework irrelevant and obsolete. Recognizing the needs of our diverse banking system and its consumers, the Congress should intervene to reaffirm the balance of our dual banking system and reject the OCC's drive to change our system of regulation and applicable law so radically without any Congressional input.

Importance of Decentralized Supervision

Maintaining a local role in consumer protection and a strong state banking system is more important than ever as we see a new round of mergers among our nation's largest financial institutions. These mergers make economic sense for the institutions involved, and may offer the customers of these institutions a larger menu of products and services at prices that reflect economies of scale. But the strength of our banking system is its diversity – the fact that we have enough financial institutions, of enough different sizes and specialties, to meet the needs of the world's most diverse economy. Centralizing authority or financial power in one agency, or in a small group of narrowly-regulated institutions, would threaten the dynamic nature of our economy.

Federal Reserve Chairman Alan Greenspan has said that our "decentralized and diverse banking structure" was arguably the key to weathering the financial crisis of the late 1980s and returning quickly to economic health. Compare the speed of this recovery to the centralized banking system of Japan, which has spent more than a decade in economic malaise as a result of the system's inability to confront its problems and address them.

State supervision and regulation are essential to our decentralized system. State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens. We can and do respond to these problems much more quickly than the federal government.

We believe the process of routine examinations of financial institutions is critical to consumer protection. The state of Idaho not only conducts regularly scheduled examinations of our state-chartered banks, but also of mortgage brokers and lenders and finance companies. It appears that these companies would escape this routine surveillance if they now become operating subsidiaries of national banks. The importance of examinations should not be underestimated; through this process our examiners often uncover and address violations of consumer protection laws before large segments of the population are affected. In 1997, Governor Phillips of the Federal Reserve said, "no system of supervision or regulation can provide total assurances that banking problems will not occur or that banks will not fail." Instead, she emphasized that the purpose is to "identify weak banking practices early so that small or emerging problems can be addressed before they become large and costly." We question how often the OCC will travel to Idaho to conduct routine examinations of these companies.

The Comptroller has argued that the laws and rules states have enacted to protect their citizens are burdensome to national banks. We are sensitive to regulatory burden, and constantly look for ways to simplify and streamline compliance. For example, I serve as the Chairman of the CSBS task force addressing predatory lending. It is the goal of the taskforce to draft an anti-predatory lending standard that can be adopted by the states, or presented to Congress, to ease the burden on financial institutions that want to operate in multiple states. The important difference between setting an anti-predatory lending standard in this manner and the OCC's unilateral action is that our process builds on our collective expertise and allows the states to continue to protect their own citizens.

As another example, the American Association of Residential Mortgage Regulators (AARMR), the group of state mortgage regulators, has adopted a uniform application for mortgage brokering or mortgage lending licensure. CSBS is promoting the adoption of the uniform license application among the states, again to ease the burden on mortgage companies wanting to do business on a multi-state basis. The uniform application is already effective in Idaho.

We must note, however, that as technology enables the drive to a nationwide financial marketplace, technology also makes compliance with both federal and state laws easier for financial institutions than at any point in our history. Since 2003 was yet another year of record earnings for the entire industry, we cannot see justification for the Comptroller's argument that national banks should be exempt from the laws that apply to any other bank or any other business in a particular state. Where is the evidence that state consumer protection laws are harming the national banking system? Why – through regulatory action – is one class of institutions being shielded from these laws?

But perhaps the compromise for regulation of operating subsidiaries lies in the states' efforts to develop uniform standards – and perhaps the standards need to be implemented by Congress to ensure their uniformity – with enforcement authority given to those who do it best: the states. This is not a new concept. The Idaho Credit Code, the law that governs finance companies, has long incorporated the Federal Consumer Credit Protection Act, including the Truth in Lending Act and the Fair Credit Reporting Act. The Idaho Residential Mortgage Practices Act incorporates the Federal Truth in Lending Act and the Real Estate Settlement Procedures Act. In this way, mortgage companies and finance companies doing business in Idaho know they have to comply with a national standard, but answer to an Idaho regulator if they harm an Idaho consumer. We further invite our regulated industries to let us know if any of the unique Idaho provisions in our laws cause a burden to their interstate business.

Securities and Exchange Commission Chairman William Donaldson welcomes state consumer-protection initiatives in the securities field, since, as he has said, federal authorities "cannot be everywhere." We applaud this approach.

Dual Banking System and History of Preemption

The dual banking system is part of our democratic heritage. The phrase "dual banking" refers not only to the parallel systems of state and federal banking regulation, but also to the interaction of state and federal laws for the benefit of our national and local economies. Since the creation of our dual banking system in 1864, all banks, regardless of their charter, have been subject to a combination of federal and state laws. The balance of state and federal authority has evolved, shaped by new state and federal statutes and by a growing body of case law.

In general, the principle that has governed the interaction of state and federal law over national banks is that federal law overrides state law where the two statutes directly conflict, or where the state law significantly impairs the national bank's ability to conduct its federally-authorized business. National banks and their operating subsidiaries have traditionally been subject to a wide range of state laws, and Congress has consistently deferred to state law in several areas.

Most relevant to the current discussion is the Riegle-Neal Interstate Banking and Branching Efficiency Act, which provided for state law to apply to the interstate branches of national banks in four key areas -- intrastate branching, consumer protection, fair lending and community reinvestment – as long as these laws did not discriminate against national banks on the basis of their charter. This applicable law provision was a key element of the compromise that produced the nationwide branching law. Congress expressed its clear intent, in report language, that states should be able to offer all their citizens equal consumer protections, regardless of whether these citizens used a state or a national bank.

The ten years since the passage of Riegle-Neal have transformed the financial services industry, and in this transformation we have seen the value and strength of our dual banking system. Banks have taken advantage of their new powers under Riegle-Neal and Gramm-Leach-Bliley to offer their customers an unprecedented range of new products and services. Many of these products and services originated at the state level.

Over the past ten years, however, we have seen a new aspect of the dual banking system's value. As new products and services have emerged, so too have new opportunities for consumer confusion and, in some cases, abuse. The explosion of the mortgage industry created a new class of lenders for nonprime borrowers, and in some cases these lenders engaged in predatory and fraudulent practices. Many states sought remedies through enforcement of existing state laws, new legislation, and financial education campaigns. Our efforts have reached thousands of borrowers and potential borrowers, punished and discouraged predatory lenders, and brought a national spotlight to this problem.

Our experience in this area shows that the dual banking system is not a museum artifact or an anachronism, but a vital and essential dynamic for promoting new financial services while offering new approaches for consumer protection.

Ten years after the passage of nationwide banking, the dual banking system is more important than ever. It ensures diversity in our financial services system, and it ensures that the regulatory system addresses local concerns as well as national concerns. In this case, that specifically means the interests of local borrowers and consumers.

The traditional dynamic of the dual banking system has been that the states experiment with new products and services that Congress later enacts on a nationwide basis. We generally discuss this history in terms of expanded powers, but the states have been innovators in the area of consumer protection, as well. States enacted CRA and fair lending statutes before the federal government did, and states are now leading the way on predatory lending, identity theft, and privacy initiatives. These state laws, which the OCC sees as burdensome to national banks, are in fact providing all of us the opportunity to see what works and what doesn't, and find the appropriate balance before seeking legislation on a national level.

CSBS does, however, recognize a new dynamic in our dual system of applicable state and federal law for financial institutions: the activism of city and local governments in setting the terms of lending in response to concerns over predatory lending practices. Many states, including Idaho, have already acted to clarify that only state and federal laws govern lending, not city or local statutes. Similar action in Congress might enhance the federalism dynamic.

While it has been served up as the poster child for OCC preemption, the Georgia predatory lending statute is, in fact, a good example of how responsive the state system can be. Seeing a need for additional consumer protections, the Georgia state legislature approved a law that took effect on October 1, 2002. Problems with this statute surfaced almost immediately. Both the financial services industry and the regulators involved went back to the legislature to seek a remedy, and the legislature passed revisions to that law on March 10, 2003 – less than six months later.

The OCC is attempting to short-circuit this dynamic with the sweeping *de facto* "field preemption" of these recent regulations by voiding all state laws that "condition" the operation of a national bank or its operating subsidiary. States may continue to seek new ways to protect their citizens, but if the OCC's regulations were to be upheld, these efforts would be ineffectual, because the laws would not apply to the customers of most of the nation's largest financial institutions who increasingly control much of the nation's financial assets.

As I said earlier in my testimony, new consumer protection laws governing these institutions would have to originate at the federal level. As you know, enacting federal legislation is a long and cumbersome process. Federal laws necessarily address problems with broad strokes that may not be appropriate for both large and small organizations within the same industry. The state system is much better equipped to respond quickly, and to tailor solutions to the specific needs of various communities and industry sectors. If you lose the states as a laboratory for consumer protections and other innovations, you lose two great attributes of our federalist system – the ability to find out what does and doesn't work, and the ability to tailor the response to the problem. New York doesn't necessarily need the solution for the problems we've identified in Idaho.

Preemption, as the Comptroller has noted, has always been part of the dynamic of our dual banking system. Congressional preemption may be necessary at times to create uniform national standards, as with the recently-enacted Fair and Accurate Credit Transactions Act. The Conference of State Bank Supervisors supported congressional preemption in this case. But we strongly oppose broad OCC regulatory preemption in the absence of express guidance from Congress or meaningful consultation with the states.

Riegle-Neal, in fact, lays out a process of notice and consultation for the preemption of state laws, and does not contemplate the kind of *de facto* "field preemption" embodied in these new OCC regulations. This process is rooted in our democratic tradition, ensuring accountability, while allowing action when necessary. The Comptroller of the Currency has justified his recent actions by saying that they will improve the operating efficiency of national banks; is this purported operating efficiency worth discarding our democratic process?

A New Class of Unregulated Institutions

Congress created a structure for functional regulation and consistently expressed concern about consumer protection when it passed the Gramm-Leach-

Bliley Act in 1999. At the time, that structure did not contemplate the creation of a class of businesses that would not be subject to ordinary state consumer protection laws. But the Comptroller is attempting to do that through these regulations.

This is an issue that transcends banking, and in some cases transcends our traditional view of financial services. With these regulations, the Comptroller seeks to exempt an entire spectrum of mortgage banks and mortgage brokers, finance companies, title companies, leasing companies, and retail securities brokerages from local laws – *if* these companies happen to be operating subsidiaries a national bank.

Furthermore, the Comptroller's recent advance notice of proposed rulemaking suggests that the definition of "operating subsidiary" for the purposes of this rule may be very broad indeed. Our traditional understanding of an operating subsidiary is one that is wholly-owned by its parent bank. The Comptroller proposes that the operating subsidiary preemptions will apply to any business where the parent bank owns *or controls* more than 50 percent of the voting or similar interest in the subsidiary, or if the parent bank "otherwise controls" the subsidiary and no other entity controls more than 50 percent of the voting stock or similar interest. How small of an ownership interest can confer these sweeping preemptions and protection from state oversight on these entities?

Mr. Chairman, this is not the action of a responsible regulator.

The OCC has said that it will provide the necessary oversight and enforcement to address consumer concerns. We question whether the agency has the resources to take on these new responsibilities. At the moment it seems that the OCC is still trying to identify the scope of these new responsibilities. The agency's recently proposed rule on operating subsidiaries made it clear that the OCC itself does not know how many operating subsidiaries are currently in business in the United States. The OCC's proposed rule would require operating subsidiaries to identify their affiliation with their parent bank and their regulator on their websites. This is a necessary and welcome requirement, but experience shows us that this type of posting does little to stop consumers from calling their state regulator or attorney general's office. Currently in Idaho national banks are identified on our website, and we provide contact information for the OCC. However, consumers of national banks still call us when they have a problem with their bank. It is our experience that consumers just want their problems solved, and their first response is to call their state regulator. Consumers will complain to the agency they feel most comfortable with, and where they believe they'll receive the most immediate attention. I'm proud to say that Idaho's citizens expect that from my office.

We have seen the OCC, on the other hand, intervene time and time again on behalf of the nation's largest banks to prevent the implementation of state consumer protection laws. In these cases, the OCC has not been the consumer's advocate.

The OCC's preemption would create an uneven playing field for national banks and state chartered banks, and that concerns us. What concerns us even more, however, is that this preemption would also create an uneven playing field for consumers. Borrowers who walk into a mortgage lender, a money transmitter office or a finance company don't know whether that business is owned by a national bank. Those borrowers have the reasonable expectation that state laws will protect them. If borrowers need to seek remedies, their first instinct will not be to complain to the OCC. More often than not, they will come to us – to the state banking departments and consumer credit agencies.

We will have to refer them to the OCC's consumer compliance center in Houston, Texas. A recent study by former Treasury official Sheila Bair found that the OCC's Consumer Assistance Group is already overwhelmed with complaints, averaging 921 complaints per employee per year.

This is a resource issue, and it is within the OCC's power to address. What is not within the OCC's power to address is the question of accountability. At the state level, we are directly accountable to our citizens. Boise is a small city and Idaho is a small state; if my office is not responsive to consumer complaints, we hear about it directly from our citizens as well as from our Governor, our legislature, and our attorney general. To whom is the OCC accountable, and what recourse do consumers have if the OCC does not resolve their complaints? The OCC would say – and has said – that these consumers have the option of pursuing their claims through litigation. It seems extreme to ask consumers to pursue their complaints in federal court, and I cannot imagine anyone advocating an increase in class action suits at the federal level. But the Comptroller's new regulations will almost certainly create more federal litigation.

Let me explain to you, briefly, the impact that the OCC's preemption will have on our small state. Only a minority of states have enacted specific "predatory lending" laws to combat abuses primarily occurring in mortgage lending. Idaho is not one of that handful of states that have enacted predatory lending laws; instead, we opted to use existing laws to combat instances of predatory lending in Idaho. But there should be no doubt that even small states like Idaho have their share of instances of predatory lending.

Idaho regulates the mortgage industry through two primary laws. One gives us authority to license, examine, and take enforcement actions against mortgage brokers and mortgage lenders. That law already exempts wholly-owned subsidiaries of banks, including national banks. The law contains certain anti-predatory prohibitions that differ from the OCC's proposal. For example, our law prohibits mortgage brokers from engaging in misrepresentations concerning mortgage loans, and from "accept[ing] any fees at closing which were not previously disclosed fully to the borrower." But it also incorporates federal standards, and authorizes our Department to take enforcement action if, for example, a mortgage broker violates the federal Real Estate Settlement Procedures Act.

The OCC's preemption would remove from our supervision operating subsidiaries beyond those that are wholly-owned by a national bank. And, indeed, to date, two operating subsidiaries of national banks have claimed that the OCC has preempted Idaho's oversight of their mortgage brokering and lending activities in Idaho.

The other law that gives us authority to combat predatory mortgage lending practices allows us to license, examine, and take enforcement actions against finance companies. Similarly, this law incorporates federal standards, specifically the federal Consumer Credit Protection Act. But it also allows the state to take action against a lender who engages in fraudulent or unconscionable conduct. For example, if the lender knows, when the loan is made, that the borrower likely cannot repay the loan, it is an unconscionable loan.

Although we have not required national banks or their operating subsidiaries to obtain licenses under this law, we have long maintained that these businesses are subject to Idaho's consumer protection provisions. The OCC would now claim that the state cannot enforce those consumer protection provisions, not only against national banks, but also not against finance companies that choose to become operating subsidiaries of those banks. One such subsidiary has already surrendered its license to the state based upon OCC preemption theories. Across the country, more then twenty national bank operating subsidiaries have stated that they will turn in their license when the OCC's final rule becomes effective. These operating subsidiaries include some of the nation's largest, such as Wells Fargo Home Mortgage, Fleet, PNC Home Mortgage and Bank of America Auto Finance.

Perhaps because we are a small state, our agency has developed effective relationships with local representatives of national banks that benefit Idaho consumers. As in most states, our residents call us if they have a problem with their bank, mortgage broker, or finance company. The OCC does not have an office in Idaho. The OCC does not have a telephone listing in Idaho's phone books. Because we worked to develop contacts with national banks, our examiners have been able to call a local or regional national bank employee to resolve significant disputes. The OCC has now directed national banks to contact them if the bank is contacted by a state official.

What do Idaho's consumers stand to lose? Our Department has five staff people dedicated to investigating consumer complaints received in person, in writing, by telephone, and by email arising from transactions with mortgage brokers, mortgage lenders, and finance companies. Over the past three years, these examiners processed 617 complaints relating to these non-depository lenders, and 247 complaints relating to national banks or their operating subsidiaries. In the same period, we returned over $3.5 million to Idaho consumers as a result of resolved consumer complaints against mortgage brokers, mortgage lenders, and finance companies, and charged an additional $216,000 in fines and penalties. Our agency conducted 274 investigations of mortgage brokers, mortgage lenders, and finance companies, and 33 investigations of national banks or their subsidiaries. In the past three years, we also completed 178 enforcement actions against non-depository lending institutions.

Under the Comptroller's new regulations, we would not have been able to take these actions if these businesses were operating subsidiaries.

I put forward two final numbers for your consideration. Over the past three years, the staff of our small agency conducted 618 routine examinations of non-depository lending institutions doing business in Idaho. These examinations are the ones that will be left undone if Idaho's mortgage brokers, mortgage lenders, and finance companies continue to surrender their state licenses to us under the claim of OCC preemption. It is my understanding that the OCC rarely performs on-site, routine examinations of national bank operating subsidiaries.

Finally, if all non-depository financial institutions in Idaho were to become op-subs, Idaho citizens would lose the protection of Idaho's laws when dealing with nearly 1,700 companies.

The OCC has already challenged individual states' efforts to enforce consumer protection laws over car dealerships, telemarketers, an unlicensed trade school and an air conditioning company because all of these businesses had financing relationships with national banks. It boggles the mind to think that we have seen the OCC defend national banks' right to partner with organizations that violate state law, but this is exactly what is happening – and this, on a grand scale, would be the immediate result of the Comptroller's new preemption regulations. These regulations would effectively allow national banks to profit by "renting" their preemption authority to agency relationships.

We believe that these regulations far exceed the Comptroller's statutory authority under the National Bank Act, which generally allows preemption only when state laws significantly interfere with a national *bank*'s ability to exercise the powers of its charter. Before Gramm-Leach-Bliley, we were used to thinking of the activities of bank operating subsidiaries as an extension of the bank itself. Now, however, the activities of a bank's operating subsidiary may be so far removed from the bank that the consumer would never make the mental connection between that business and the parent bank. State regulation and oversight of these businesses, which often required separate licenses, filled any oversight gap and made sure that consumers had a local contact for complaints.

And the state mechanism for responding to consumer complaints - many related to the operating subsidiaries and affiliates of national banks - has been working, with millions, even hundreds of millions of dollars – as previously mentioned in the discussion of the Household settlement -- being returned to mistreated consumers.

States handle financial consumer complaints not only through our banking departments, but also, as I mentioned, through separate departments that address non-banking consumer credit issues. The states already have networks in place for referring complaints to the appropriate agencies, and to law enforcement authorities when necessary. The states dedicate hundreds of employees to handling these consumer complaints, and these resources strain to keep up with the demand.

The Comptroller's regulations displace this network for national banks and their operating subsidiaries. What is the justification for displacing existing resources -- for pushing aside the local cop on the beat? With limited resources at both state and federal levels, we should be talking about sharing responsibilities, not preempting valuable resources.

Conclusion

For more than 150 years, Congress has been careful to balance the interests of local government with the interests of a nationwide banking system. In enacting new banking laws, Congress has consistently paid deference to state laws in general and state consumer protection laws in particular. Riegle-Neal stipulated that state laws on intrastate branching, community reinvestment, fair lending and consumer protection would continue to apply to the branches of national banks, *unless* these laws discriminated against national banks or were specifically preempted by federal law.

The Comptroller's proposed regulations have the opposite effect, with the perverse result that state consumer protection laws would discriminate against state-chartered financial institutions. In some states, we may see legislatures move to reduce these consumer protection laws to avoid this discriminatory treatment. This is not in the public interest. Surely it was not Congress's intent.

This debate should not be about protecting or advancing one charter over another. It should not be about turf. It should be about creating the best structure for a financial services system that allows a wide range of financial institutions to compete effectively and make their products and services available to all segments of our nation, and that offers consumers protection and remedies against fraudulent and misleading practices – no matter the charter of the consumers' financial institution. If Congress finds that federal preemption is necessary to achieve this goal, we will accept that. With his actions, however, the Comptroller of the Currency is trying to cut off this discussion altogether.

The Conference of State Bank Supervisors supports nationwide banking. We support interstate operations and the ability of customers to be able to move and travel with their financial institutions, and we have worked hard to create a structure that facilitates interstate branching. We support competition in the marketplace and meaningful customer choice. We constantly seek opportunities to decrease regulatory burden and help our largest financial institutions develop more efficient operating systems. But this efficiency cannot come at the expense of the consumer or at a competitive disadvantage to the thousands of community-based institutions that serve these consumers.

Our highly diverse financial system is the envy of the world. The lesson that much of the world has never learned is that the flexibility and responsiveness of the U.S. financial markets and financial regulators are the result of our decentralized regulatory system. CSBS believes that the OCC's *de facto* "field preemption" is a dangerous move toward centralization that could rob our dual banking system of one of its greatest attributes.

We urge Congress to look carefully at this regulation and its implications, and consider whatever actions may be necessary to clarify the interaction of state and federal laws, restore the balance of the dual banking system, and reassert its authority over federal banking policy.

Ultimately, you must decide whether you are comfortable putting your constituents in the hands of an unelected official who, with the stroke of a pen, seeks to sweep aside all state consumer protection laws, and has effectively declared all national banks and their operating subsidiaries in your state exempt from the authority of your Governor, your state's Attorney General, your state legislature and your state's financial regulators.

The Conference of State Bank Supervisors wants to be part of the solution. We look forward to working with the Congress and with the federal banking agencies to build a structure that facilitates nationwide banking without harming our economies or the consumers our institutions serve.

Thank you for your attention. I look forward to answering the Committee's questions.

ATTACHMENTS:

April 5, 2004
Examples of Customer Restitution Returned by State Banking Departments

The following summary highlights the success that a cross section of state banking departments have achieved in investigating consumer complaints against national banks and their subsidiaries that resulted in restitution to consumers in their respective states. The examples highlight the role that states play as local cops on the beat with the ability to pursue small dollar amount errors and omissions that might be overlooked by a centralized approach through the OCC's efforts only. The examples, alternatively, highlight large dollars states have returned to the consumers in their states because of violations of state consumer protection laws that have been broadly preempted by the Comptroller's recently finalized regulations.

Connecticut

The Connecticut Banking Department has worked closely with CT consumers to pursue complaints consumers have brought to the Banking Department's attention that have involved national banks and their subsidiaries. Listed below are the total number of such complaints for the years 2001, 2002 and 2003. Included next to the number of complaints are the total dollars recovered or adjusted for consumers during each year. Additionally, a list of National Banks and/or their operating subsidiaries is provided for your information. The reimbursement amounts are generally a result of overcharges, billing errors, etc., that the Department contacted national banks and their operating subsidiaries about and are not a result of specific enforcement of a state statute.

In 2001 the Departments pursued 329 complaints against the national banks listed below and their efforts returned $80,120 to consumers. In 2002 the Department pursued 312 complaints and their efforts returned $194,410 to consumers. In 2003 the Department pursued 318 complaints and their efforts returned $96,919 to consumers.

The complaints were against the following companies:

Bank of America
Bank One
Citibank
First Horizon
First USA
Fleet
MBNA America
National City Mortgage
Wachovia
Wells Fargo

Some of the more serious complaints have included the failure to honor mortgage loan rate locks, assessment of fees in excess of state limits and requirements that the borrower obtain hazard insurance in the amount of the mortgage despite the fact that many insurers will not issue coverage in excess of the replacement value, resulting in the denial of the loan. Although the CT has state statutes that offer protection for the consumers in these areas, the Department noted that they are often powerless to enforce the statutes when a national Banks or a national bank operating subsidiaries is involved.

New York

Citifinancial

The New York State Banking Department examined Citifinancial, a subsidiary of Citicorp's holding company. Due to the investigation, Citifinancial had to recast and make refunds on 1,372 loans due to Part 41 (NY's High Cost Home Loan regulation) exceptions and consumers were refunded **$694,374.** *CSBS is including this example because the OCC newly finalized rules provide an attractive incentive for conversions to the national bank operating subsidiary structure due to sweeping preemption standards.*

On 205 of the above loans the debt to income ratio exceeded 50% and there was no evidence to indicate that the borrower had the capacity to repay the loan at the time that it was made, nor were there any compelling reasons that would have justified the loan. It appeared that the banker was relying on future increases in the value of the collateral for repayment.

1,167 loans were found to have charged points and fees that exceeded the Part 41 threshold. The banker had incorrectly excluded fees paid to an affiliate from the Part 41 calculation. The excluded fees were appraisal and title fees. In addition, the banker had been excluding renewal loans where no additional funds were disbursed from Part 41. The banker also was excluding premiums for membership in protection plans in determining the borrower's ability to repay.

Loans that met the banks internal guideline for referral up to another Citigroup lender were not made. As a result the borrower had to pay a higher interest rate on a Citifinancial loan. Additionally, when a borrower did meet the established guidelines the system allowed a bypass whereby the customer was not informed of this option.

The NY State Banking Department also found instances where consumers were sold products for which they did not qualify. An example was selling disability insurance to unemployed borrowers and to borrowers on active duty military service.

ABN Ambro

ABN Ambro, an operating subsidiary of a national Bank, had funded 22 loans that were broker originated. They did not comply with Part 41, our High Cost Loan regulation, and had to revise each of these loans and make refunds to consumers totaling **$9,417**.

In total, the New York State Banking Department secured consumer restitution totaling $42,520 in 2003; $102,174 in 2002 and $706,307 in 2001 from national bank subsidiaries doing business in New York. Much of the money returned to consumers resulted from NY State Banking Department examinations of mortgage lenders in NY that had not followed the state's high cost home loan regulations (Part 41.)

Maine

These are examples of investigations the Department's Office of Consumer Credit Regulation conducted that identified violations in Maine statutes (that resulted in restitution for Maine consumers:

Title 9-A

§5-110 - Notice of Right to Cure
http://janus.state.me.us/legis/statutes/9-A/title9-Asec5-110.html

National Bank Finance Company Subsidiary - Repossession without proper notice.

§6-111 - Unconscionable Agreements
http://janus.state.me.us/legis/statutes/9-A/title9-Asec6-111.html

National Bank Mortgage Company Subsidiary - Tried to induce a consumer to refinance a loan which would have created a loan balance well above the value of the property and would have resulted in payments too high for the borrower's income. (predatory lending practice)

§8-305 - Notice of Recurring Fees
http://janus.state.me.us/legis/statutes/9-A/title9-Asec8-305.html

National Bank Credit Card Subsidiary - Billed annual fee on credit card without advance notice.

§8-401 - Fair Credit Billing
http://janus.state.me.us/legis/statutes/9-A/title9-Asec8-401.html

National Bank Mortgage Company Subsidiary - Failure to correct or investigate inaccurate application of payments on consumer credit transactions.

National Bank Mortgage Company Subsidiary - Inaccurate payoff calculation.

In 2003 such violations resulted in $10,000 in restitution to consumers.
In 2002 such violations resulted in $8,000 in restitution to consumers.
In 2001 such violations resulted in $8,000 in restitution to consumers.

Tennessee

The Tennessee Department of Financial Institutions reported that due to violations of their statutes governing a range of service fees and related charges, they ordered subsidiaries of national bank holding companies to return $**121,859.18** to TN consumers in 2003 due to 36 investigations that uncovered violations. In 2002 they ordered that

$1.4 million be returned to TN consumers due to 70 investigations that uncovered violations.

Given the substantive dollar remedies ordered by states like NY and TN, we include these examples because the OCC's final rules provide a real incentive to change their structure to that of a national bank operating subsidiary in order to evade state consumer protection laws through preemption.

Wisconsin

We have attached an exhaustive breakdown of complaints that the WI Department of Financial Institutions conducted of national banks and their subsidiaries. As a result of the investigations the Department conducted in 2003 the Department worked with national banks and their subsidiaries which resulted in the return of **$10,486** to WI consumers. In 2002 the Department's pursuit of consumer complaints against national banks and their subsidiaries resulted in **$17,170** being returned to consumers; and in 2001 the Department's work with such institutions resulted in **$32,044** in refunds/restitution to consumers.

The Department ordered the restitution based on violations of a range of WI statutes such as accounting errors that resulted in incorrect extra charges to consumers and unlawful collection practices

Examples of Complaints Against National Banks or Their Subsidiaries (State of Wisconsin)			
	2003	**2002**	**2001**
National Banks	65	42	42
Credit Card Subsidiaries	64	71	63
Mortgage Banking Subsidiaries	7	2	2
Other		1	4
Total	**136**	**116**	**111**
Accounting Error	9	5	10
Additional Charges	12	8	2
Advertising	1	6	9
Auto Lease	2	1	1
Billing Error	9	13	22
Change in Credit Terms	6	8	2
Checking Account Procedures	13	9	7
Collection - 3rd Party Contact	1	0	2
Collection - General Practices	2	1	1
Collection - Harassment	0	1	0
Collection - Late Calls	0	2	0
Collection - On the Job Contact	1	0	1
Contract Validity	2	0	1
Credit Card/Check ID	0	0	1
Credit Denial	2	2	1
Credit Insurance	2	3	3
Credit Report - Inaccurate	5	1	0
Credit Report - Misc.	1	0	3
Debit Cards	0	0	1
Default Notice	0	0	1
Disclosures	3	5	1
Discrimination	2	0	0
Disputed Debt	17	6	2
Finance Charges	1	0	2
Identity Theft	1	0	1
Interest Rate	2	0	0
Miscellaneous	0	4	0
Misrepresentation	2	2	2
Negative Option	0	1	0
Negotiable Instruments	0	1	0
No Signed Credit Agreement	0	5	1

Notice of Assignment	1	0	0
Payoff Inaccurate	1	3	5
Property Insurance	2	1	0
Real Estate/Mortgage/Escrow	17	11	9
Repossession of Collateral	0	0	2
Savings Accounts	5	4	4
Trust Account Procedures	2	0	0
Unauthorized use of bank account	4	2	1
Unauthorized use of credit card	3	6	10
Unfair Practices	3	4	0
Unsolicited Credit Card	2	1	3
Total	**136**	**116**	**111**