Testimony of William M. Isaac
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The United States Senate
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Mr. Chairman, members of the Committee, I am William M. Isaac, Chairman of The Secura Group, a financial services consulting firm headquartered in Washington. Prior to founding Secura in 1986, I served eight years on the board of the Federal Deposit Insurance Corporation, five as Chairman during the banking crisis of the 1980s. My entire career has been spent in the financial services industry in various capacities, including a number of years as an attorney specializing in banking law.

I am appearing today to speak on behalf of the regulations recently issued by the Comptroller of the Currency clarifying when the operations of national banks are subject – and not subject – to the jurisdiction of the states. The Comptroller notes that he is attempting to codify, not alter, existing law.

The Comptroller says, in a nutshell, that contract law, property law, environmental law, and other state laws of general application to all companies also apply to national banks. But states may not attempt to regulate the powers and activities of national banks or create impediments to a national bank's exercise of its powers.

The Comptroller's action is being challenged by most of the state attorneys general and the Conference of State Bank Supervisors. They contend that the Comptroller is forging new ground and if his actions are upheld, it will undermine the dual or state/federal banking system and will injure consumers.

Nothing could be further from the truth in my judgment. I believe the Comptroller's preemption regulations are: i) pro-consumer; ii) very much in the best interests of all banks, both state and nationally chartered; iii) essential to the preservation of our dual or state/federal banking system; iv) fully in accord with 140 years of statutory and case law, including decisions by the United

States Supreme Court; and v) quite similar to the federal preemption rules applicable to federally chartered thrifts and credit unions, about which there appears to be no controversy.

The larger national banks do business throughout the nation. They cannot operate effectively and efficiently if they must tailor their products to the laws of 50 states and who knows how many local jurisdictions. For example, a few years ago the city council of Santa Monica, California passed an ordinance purporting to regulate ATM fees within the city. Some national banks refused to allow non-customers access to their ATMs in Santa Monica until the ordinance was repealed. Ultimately the courts struck down the ordinance as an illegal interference with the business of a national bank.

Inefficient regulation takes an even higher toll on regional or community banks that serve customers across jurisdictional lines. The smaller the bank the smaller the base of customers over which to apply the extra compliance, legal, technology and paperwork expenses caused by multiple regulatory schemes. Those who care about the vitality of our nation's regional and community banks should not overlook the impact of this issue on them.

It serves neither banks nor customers of banks to make it incredibly inefficient and expensive for banks to operate across jurisdictional lines. It would be a nightmare if national banks were required to comply with scores, if not hundreds, of state and local regulations on their products, services and activities. The result would be fewer services and higher prices for bank customers.

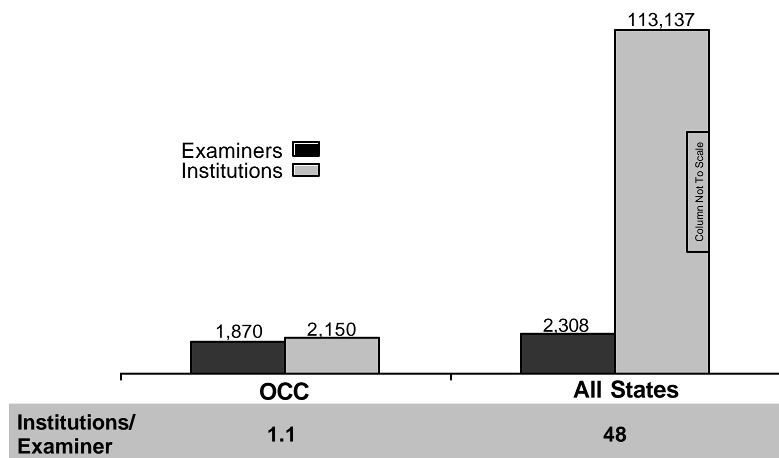
The federal government has passed reams of laws, regulations and rules to protect the interests of consumers, and the federal banking agencies have devoted very substantial resources to making sure those laws, regulations and rules are enforced. The Comptroller's Office, in particular, has been very aggressive with its enforcement and has taken a series of steps, including new anti-predatory lending standards, to prevent abusive practices.

The contention by various state attorneys general that they are more effective on behalf of consumers than the Comptroller of the Currency strains credulity. The Comptroller has nearly two

thousand supervisory personnel dealing with national banks each day. Those personnel have enormous legal authority and even greater moral suasion with respect to national banks. While an attorney general is huffing and puffing and threatening to go to court against a bank, without much effect, all it takes is a frown from the Comptroller to bring a national bank into line. This is particularly true of the larger banks, which simply have no choice but to maintain the very best of relations with their regulators if they wish to grow and prosper.

I worked closely with state regulators throughout the country when I served as Chairman of the FDIC. Indeed, the FDIC shared oversight with the states of some 8,000 state banks. I know of no state banking department that is better equipped than the Comptroller of the Currency to supervise banks for either compliance or safety and soundness purposes.

Many, if not most, of the state banking departments were chronically short of financial and personnel resources and relied heavily on the FDIC to assist in the supervision of their banks and in the training of their personnel. I find it difficult to imagine how or where the state banking departments would find the resources to take on the additional duties of overseeing national banks within their borders. Indeed, the chart shown below reveal that the Comptroller of the Currency has one commissioned examiner for each institution it supervises, while the state banking departments have one examiner for every 48 institutions they supervise.



I have long been an ardent supporter of the dual or state/federal banking system. It has led to much innovation at both the state and federal levels, as the states and the Comptroller of the

Currency have attempted at various times to improve the competitive position of their banks. When the federal government imposed a punitive tax on bank notes issued by state-chartered banks in the 1800s, for example, state banks responded by inventing what we know today as the checking account. The Comptroller of the Currency led the way toward a more modern and competitive banking system with a series of rulings in the 1960s, including the introduction by a national bank of the negotiable certificate of deposit.

There are two ways to keep the dual or state/federal banking system in balance. One way is to bring down the side that has an advantage – to take away the advantage. This is what the Clinton administration was attempting to do when it proposed that state banks pay for federal examinations to equalize their supervisory costs with those of national banks. And this is what the CSBS is attempting to do when it attacks the preemption powers of the Comptroller. When these kinds of things take place, the dual banking system becomes a serious burden to the industry and its customers – it reduces services and innovations and raises costs.

The other way to keep the system in balance is to strengthen the side that has the disadvantage. If, for example, it costs more to examine and supervise national banks, let us search for ways to reduce those costs instead of imposing additional expenses on state banks. Or if preemption rules allow national banks to avoid redundant regulation at the state and local levels, perhaps states can enter into compacts to afford similar treatment to their banks. When the dual banking system operates in this fashion, it is truly beneficial to banks and their customers – it results in a more innovative and competitive banking system, which benefits all of us.

Currently the balance between state and national banks is tilted in favor of state-chartered banks. Their supervisory costs are lower, and in many states they have broader powers to engage in a wider range of activities. Moreover, many bankers believe that their state regulator will likely be more responsive and attentive to their concerns. The Comptroller has lost many banks to the state system over the past decade or two.

If Congress were to repeal the Comptroller's historical power to preempt state laws that interfere with the authority and activities of national banks, there is a very good chance that the national banking system will be brought to the brink – possibly bringing an ironic end to our dual

banking system and higher prices to the very consumers we claim we want to protect. Adding irony on top of irony, the states would gain little authority, as most of the larger banking companies would switch their national bank charters not to state charters but to federal thrift charters, which offer even clearer federal preemption and the ability to offer an even broader range of retail financial services.

Before closing, I want to mention the brouhaha about the Comptroller's ruling that operating subsidiaries of national banks are entitled to the same protection as national banks against state interference. The CSBS, together with 35 state attorneys general, filed an amicus brief against the Comptroller's preemption rules for operating subsidiaries in Wachovia v. Burke.

Wachovia, a national bank, created an operating subsidiary to carry out mortgage banking operations. The CSBS contends that the states are entitled to regulate operating subsidiaries. The Comptroller believes these subsidiaries are entitled to the same protections as national banks so long as they are engaged only in activities permissible to national banks.

While I believe the Comptroller is correct, as a matter of law, what really struck me when I read about this case was the triviality and futility of the CSBS position. Even if the CSBS position prevails, Wachovia appears to have readily available alternatives. It can shift its mortgage banking activities from the operating subsidiary to a national bank or a federal savings bank charter. In either case, the entity will be shielded from inappropriate state regulation.

In sum, I believe the Comptroller's preemption regulations are on a sound legal and public policy footing. They are good for our financial system, good for consumers and essential to the preservation of our state/federal banking system. I urge the members of this committee to support the Comptroller's efforts to maintain a strong and responsive national banking system.