STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE
THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

SUBMITTED BY
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PRESIDENT

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On behalf of 1 million members of the NATIONAL ASSOCIATION OF REALTORS® involved in all aspects of the residential and commercial real estate industry, I am appearing before you today to share our strong opposition to the Office of the Comptroller of the Currency (OCC) regulation that preempts state laws regarding real estate lending and other state consumer protection laws. This rule is another example of federal regulators run amok. It is clearly an effort to grant preferable treatment to national banks and their operating subsidiaries by misinterpreting existing law and mischaracterizing legal precedent. REALTORS® are greatly troubled by this turn of events. This action is bad for consumers, bad for homeowners, bad for small businesses, and bad for our members.

We are not alone in our opposition to this rule. We are joined by all fifty Governors, all fifty State Attorneys General, all fifty State Banking Supervisors, all fifty State Legislatures, State Real Estate Commissioners, the National Association of Homebuilders, the National Association of Mortgage Brokers, the Center for Responsible Lending, the Consumer Federation of America, the National Association of Consumer Advocates, AARP, and several other consumer protection organizations.

First, I would like to highlight the difference between what the rule *actually* says in plain English, and the more limited description of the rule that is being put forth in the public pronouncements, private correspondence, and testimony of the OCC's representatives to bankers, REALTORS® and Members of Congress.

Then I would like to review why REALTORS® believe *Congress* needs to reassert its authority over the OCC and stop this unelected and biased regulator from adopting regulations that could profoundly change whole industries. These regulators should not be in the business of picking winners and losers in the marketplace. If we are not going to allow the markets to operate on a level playing field, then that is a decision for Congress to make.

REALTORS® are very concerned that the OCC continues to avoid recognizing the plain meaning of the words written in their rule as they make public pronouncements that "attempt to set the record straight." In a speech before the New York Bankers Association Financial Services Forum in New York on March 25, 2003, First Senior Deputy Comptroller and Chief Counsel Julie Williams stated that "(t)he preemption rule adds provisions to our regulations expressly addressing the applicability of certain listed types of State laws to national banks' lending and deposit-taking activities… The new regulation only preempts the types of laws listed in the rule."

That is not how the rule reads. The clear and unambiguous language of the rule, 12 C.F.R. §7.4009, states that its preemptive effect "govern[s]" with respect to any national bank power or aspect of a national bank's operations that is not covered by another OCC regulation. Moreover, the OCC's Federal Register notice announcing the adoption of the preemption rule expressly states:

> The provisions concerning preemption identify types of state laws that are preempted, as well as the types of state laws that generally are not preempted,

with respect to national banks' lending, deposit-taking, and other operations. (Emphasis added.)

69 Fed. Reg. 1904 (January 13, 2004).

The Federal Register preamble further provides:

> The provisions concerning preemption of state laws are contained in 12 CFR part 34, which governs national banks' real estate lending, and in three new sections to part 7 added by this final rule: §7.4007 regarding deposit-taking activities; §7.4008 regarding non-real estate lending activities; and §7.4009 regarding the other Federally-authorized activities of national banks. (Emphasis added.)

Id.

Moreover, the announcement indicates that the addition of §7.4009 addresses the applicability of state law with respect to activities that §§7.4007 and 7.4008 do not:

> The question may persist, however, about the extent to which state law may permissibly govern powers or activities that have not been addressed by Federal court precedents or OCC opinions or orders. Accordingly, as noted earlier, new § 7.4009 provides that state laws do not apply to national banks if they obstruct,

> impair, *or condition* a national bank's ability to fully exercise the powers authorized to it under Federal law, including the content of those activities and the manner in which and standards whereby they are conducted. (Emphasis added.)

69 Fed. Reg. at 1912.

REALTORS® believe the language of the OCC notice makes it very clear that national banks could rely on this rule as a new basis of federal authority if they choose to ignore state laws that otherwise apply to activities other than lending and deposit-taking. That is the clear meaning of the words used in the rule, unlike the carefully guarded words used by OCC staff to describe the rule in public speeches and private correspondence.

We are particularly concerned that the Comptroller's recent action will inevitably have severe adverse consequences on the public. The OCC has established a brave new world in which the agency's word is paramount. Anyone with the courage to challenge the OCC simply does not understand how important it is that national banks and their operating subsidiaries conduct business without the need to comply with state law. Our reading of the new rule is that it establishes a framework by which a national bank or its operating subsidiary can, in reliance on the Comptroller's new rule, ignore a state law merely because it concludes that the law conditions the ability of the national bank or its operating subsidiary to do business. The OCC has subverted the carefully constructed structure of consumer protection laws and regulations that states have developed over the past 25 years. He has put in train a process that, if left unchecked, will inevitably lead to the unbridled expansion of national bank powers without

regard to laws that state legislatures have determined should apply to all competitors for the protection of the public.

REALTORS® urge this Committee to examine these remarks and the language of the rule itself so that we can at least agree there is a difference. The law requires a plain reading of the language used in the rule, and Congress should base its investigation on those words.

Before I address our concerns about the impact that this rule will have on our members, I would like to raise two important points regarding the OCC's application of this rule to operating subsidiaries.

REALTORS® believe the OCC's preemption rule represents a classic case of "shoot first and ask questions later" in that it is clear the agency had little notion of the magnitude and impact of this final rule. In issuing the final regulation, the OCC stated that the amendments to parts 7 and 34 apply to both national banks and operating subsidiaries. Yet, it is now readily apparent that the OCC does not have a firm grasp on the number of operating subsidiaries national banks control. Yet these subsidiaries, many of which are state corporations, now benefit from the exemption from state consumer protection laws. Just last week the OCC announced a proposed rule that would require national banks to file an annual report to the agency identifying their operating subsidiaries. The OCC indicated that it will post the information obtained from these reports on its website so that consumers can determine if companies they do business with are subsidiaries of national banks. Consumers would then be able to direct complaints regarding the company to the OCC rather than to state consumer protection authorities. The proposal is clearly an attempt

by the OCC to stem the storm of public criticism that has arisen from the portion of the new rule that attempts to prevent state authorities from enforcing state consumer protection laws against national banks and their operating subsidiaries. Since companies are rarely identified as being operating subsidiaries of national banks, consumer groups and state authorities have complained that consumers will be thwarted because of the difficulty in determining to whom they should direct their complaints.

The OCC's proposal does little to meet the objections of consumers and state authorities. This jury-rigged process is unworkable and will do little to benefit consumers. Does the OCC really believe that consumers will log on to http://www.occ.treas.gov when they have a problem with a company they do business with? How many consumers even know that the OCC is a bureau of the Department of the Treasury? It is unreasonable to think that consumers should be sensitive to the difference between a national bank operating subsidiary and other companies they do business with. This is yet another one of the many arbitrary actions taken by the OCC in recent months to tilt the competitive balance in the financial services sector in favor of national banks.

The second point I want to raise regarding operating subsidiaries is our position that national bank operating subsidiaries do not possess the same powers of national banks. REALTORS® believe the OCC has misapplied federal law and preexisting OCC regulations to include operating subsidiaries in this new rule. More importantly, this misapplication threatens to undermine the power of states to determine under what conditions companies organized under state law may operate.

Operating subsidiaries are not national banks. They are formed under state law, and derive their power from state corporate law. The OCC does not issue charters to create operating subsidiaries. Only the state can do so. As a creature of state law, state authorities determine what the company can do, and what laws the company will be subject to. REALTORS® fail to see how a federal officer such as the Comptroller of the Currency can make a determination that federal law establishing powers of a national bank can be transferred to a company that is created by state law. The OCC has put the rabbit in the hat by ignoring basic principles of corporate law. Congress has not granted national bank powers to state chartered entities, and in the absence of Congressional action, we believe that the Comptroller does not have the ability to confer national bank powers on operating subsidiaries. As such, this new rule as applied to operating subsidiaries is legally suspect.

Now I would like to discuss REALTORS® concerns about the effect of the rule on our members, both immediately and in the future. I will touch on why we believe that the OCC has overstepped its authority and why Congress needs to act now to rein in the OCC.

Many REALTORS® who operate mortgage, title, appraisal and other businesses are unfairly impacted by this unbridled grant of preemption for national banks and their operating subsidiaries. The OCC stated in its rule release that requiring state licenses could "create higher costs and operational burdens that banks either must shoulder, or pass onto consumers, or that may have the practical effect of driving them out of certain businesses." While it may require higher costs, those costs are shared by <u>all businesses</u> that operate within that state. Is it fair for national banks to be exempt? National banks and their subsidiaries have recently enjoyed their

most profitable years in history. We don't think these profits suffered from compliance with state laws. The OCC seems to have ignored the old saying that "if it ain't broke, don't fix it."

We fear that the negative impact of this rule would only become worse if our efforts to prohibit the proposed real estate brokerage, leasing and management rule fail. If the OCC's logic prevails, it is not too much of a reach to conclude that the OCC would preempt state real estate licensing and continuing education requirements for national bank real estate operations. Is this what Congress intends?

The effort to concentrate consumer protection regulation in the federal government should only be considered by *Congress* after a careful and complete examination determines that our nation's dual banking system has failed in some way. We believe our dual banking system continues to be the best in the world. It is a decentralized market that provides a stable supply of credit to every sector of our economy. As incubators of new and innovative products, state banks help REALTORS® put American consumers in homes. The dual banking system requires state regulators who are closer to consumers to provide remedies to those who are injured by the acts of financial institutions. Even if the OCC has the desire, does it have the resources to effectively protect consumers in every state, city and neighborhood where national banks and their operating subsidiaries do business?

The OCC has consistently relied on the broadest misinterpretation of the law to determine that national banks may avoid state consumer protection, insurance and lending laws due to their federal charter. Congressional intent is unclear, and the OCC currently is taking advantage of this

lack of clarity. Nevertheless, Congress has repeatedly upheld the dual banking system and limited the authority of the OCC to preempt state laws.

Are we to believe that Civil War necessities should apply to our modern banking system, as the OCC implies in its citing of preemptive authority? Surely, none of these existing consumer protection and licensing statutes threaten to destroy any national bank today.

This rule follows a predictable pattern of national banks working with their regulator, the OCC, to gain greater market share and an expanded portfolio. Their efforts in the early 1990's to obtain broad insurance powers are illustrative. These efforts led to the *Barnett* case.

The applicable language granting authority to the OCC to preempt state laws found in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996) holds that states cannot

> "forbid, or (to) impair significantly, the exercise of a power that Congress explicitly granted. To say this is not 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 Court continued by citing three supporting cases where the Court held certain state laws did not "unlawfully encroach,"[1] would not "destro[y] or hampe[r]"[2] and do not "interfere with, or impair"[3] national banks' functions, rights or privileges.

[1] *Anderson Nat. Bank* v. *Luckett*, 321 U.S. 233, 247-252 (1944) (state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights and privileges of national banks.").

It was only after the conclusion of this case that national banks redoubled their efforts to obtain legislative authority to broadly operate securities and insurance businesses. They were finally successful with the Gramm/Leach/Bliley Act that spelled out how they could enter these businesses.

After Congress carefully crafted language that codified the *Barnett* decision, the OCC and its partner banks continued to push the envelope. Congress established in this regard that states could not "prevent or significantly interfere with the national bank's exercise of its powers" in Section 104(d)2 of the Gramm/Leach/Bliley Act. Although Congress never indicated any other standard would be appropriate for determining preemption of state laws, the OCC relied on different language from the *Barnett* case to support its preemption of state consumer protection, insurance and lending laws.

The OCC continues to twist the law to meet its ends. NAR believes those ends are to increase the value of the federal charter at the expense of state licensing and consumer protection measures. As an agency whose very existence depends on the assessments that its member banks render, it is in the OCC's best interest to promote the healthiest and most profitable institutions it can. That is an admirable goal that produces safe and sound national banks. But that promotion should not become so relentless that it crosses the line to unfairly prejudice other institutions not under the auspices of the OCC.

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[2] *McClellan* v. *Chipman*, 164 U.S. 347, 358 (1896) (application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not "destro[y] or hampe[r]" national banks' functions).

NAR has consistently argued that Congress must not allow unelected regulators unfettered interpretation and enforcement of all laws as they see fit. There is just not enough attention paid by these agencies to public comment or Congressional opposition. Although some leeway must be granted to regulators to fashion the most effective regulation, recent actions prove that some Congressional contraction of authority is necessary.

Even House Financial Services Committee Chairman Michael Oxley questioned the OCC's preemption efforts to overrule the Massachusetts Consumer Protection Act. (Oxley letter to Treasury Secretary O'Neill, April 22, 2002). In that letter, Chairman Oxley noted that the GLBA conference report "explicitly states that it was 'recognizing the primacy and legal authority of the States to regulate insurance activities of all persons.' " (Emphasis added.) The OCC seems to have no trouble ignoring specific legislative language or intent in the area of insurance activities.

The OCC should not have the ability to determine the winners and losers in a marketplace through broad preemption of state laws for national banks. All other national and local businesses continue to meet the regulatory burden of complying with the laws that protect this country's consumers against all but national banks and their subsidiaries. There is no valid public policy to create such a special class of banks.

[3] *National Bank v. Commonwealth*, 76 U.S. 353, 362 (1870) (national banks subject to state law that does not "interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the Federal] Government.").

No other federal regulator has been as callous in its disregard for consumer protections, and no other regulator has so fiercely fought against a dual regulatory system in this country. The Securities and Exchange Commission and the states both enforce consumer protections and securities laws over this industry. The Food and Drug Administration protects Americans in cooperation with state health authorities. The Federal Trade Commission operates closely with state officials.

The OCC has historically argued that consumers and businesses can "take their business elsewhere" if they do not like how national banks operate. This "free market rhetoric" loses quite a bit of strength when one considers how only a few huge banks are coming to dominate that market. The opportunities to utilize other businesses are shrinking due to the continual granting of special privileges to national banks. This privilege has now been extended by the OCC to state incorporated operating subsidiaries. This latest salvo could destroy the dual banking system, leading to an oligopoly of huge multinational banks that can disregard state licensing and consumer protection laws. This situation would certainly lead to eventual problems that Congress would need to rectify. Congress should address the situation now before these problems occur.

The consolidation of so many financial institutions into only a few huge banking conglomerates has troubled REALTORS® for some time now. Our concern is only heightened when a regulator can finalize rules like this over the objection of businesses, consumers, states, and many Members of Congress.

Congress should not let this situation continue. Congress needs to rein in the regulators before these actions lead to untenable consequences.

Maybe it is time for Congress to amend the Civil War era National Bank Act to make it abundantly clear that state consumer protection and licensing laws apply to national banks and their operating subsidiaries, and to prohibit the OCC from unilaterally preempting these laws unless they truly discriminate against national banks.

REALTORS® stand ready to support such efforts and we appreciate your attention to this issue.