TESTIMONY OF

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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 Arthur Wilmarth, a Professor of Law at George Washington University.[1] Thank you for inviting me to appear before your Committee to discuss my concerns regarding two notices of final rulemaking issued on January 7, 2004, by the Office of the Comptroller of the Currency ("OCC"). A more detailed presentation of my views on the OCC's rules will be published this spring in the *Annual Review of Banking Law*.[2]

In one rulemaking notice, the OCC adopted regulations that preempt a broad range of

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[1] B.A. Yale University, J.D. Harvard University. I have been a member of the law faculty of George Washington University since 1986. The views presented in this testimony are my own and should not be attributed to George Washington University or any other organization. I have provided legal advice to state banking departments and the Conference of State Bank Supervisors ("CSBS") for more than twenty years. I am presently acting as counsel for state officials appearing as *amici curiae* in the following two court cases, which raise legal issues related to the subject matter of my testimony: Wachovia Bank, N.A., et al., v. Burke, Civil Action No. 3:03 CV 0738 (JCH) (D. Conn.), and Wachovia Bank, N.A., et al., v. Watters, Civil Action No. 5:03-CV-0105 (W.D. Mich.).

[2] Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection,* 23 ANNUAL REVIEW OF BANKING LAW (Boston Univ. School of Law, Spring 2004) (forthcoming) [hereinafter "Wilmarth, *OCC Preemption Rules*"].

state laws from applying to the activities of national banks.[3] Those rules declare that state laws are preempted whenever they "obstruct, impair, or condition a national bank's ability to fully exercise" its federally-authorized powers, either directly or through operating subsidiaries.[4] The regulations effectively bar the application of *all* state laws to national banks, *except* where (i) Congress has expressly incorporated state-law standards in federal statutes,[5] or (ii) particular state laws have only an "incidental" effect on national banks. The OCC has said that state laws will be deemed to have a permissible, "incidental" effect *only if* such laws (a) are part of "the legal infrastructure that makes it practicable" for national banks to conduct their federally-authorized activities, and (b) "do not regulate the manner or content of the business of banking authorized for national banks."[6] In other words, state laws will apply to national banks *only if* the OCC finds that they *promote* the ability of national banks to do business.[7] The preemptive effect of the OCC's rules extends not only to national banks but also to their operating subsidiaries.[8]

The OCC has deliberately crafted its rules to accomplish a sweeping preemption of state

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[3] Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (issued Jan. 7, 2004) (to be codified at 12 C.F.R. pts. 7 & 34) [hereinafter "OCC Docket 04-04"]. These regulations were issued in proposed form at 68 Fed. Reg. 46119 (proposed Aug. 5, 2003) [hereinafter "OCC Docket 03-16"].

[4] OCC Docket 04-04, *supra* note 3, at 1911-13.

[5] *See, e.g.,* 12 U.S.C. § 36 (governing branching by national banks); id. § 92a (governing the fiduciary powers of national banks).

[6] OCC Docket 04-04, *supra* note 3, at 1911-13.

[7] *See* OCC Docket 03-16, *supra* note 3, at 46122, 46128.

[8] *See* OCC Docket 04-04, *supra* note 3, at 1905, 1913. Under the OCC's regulations, a subsidiary of a national bank qualifies as an "operating subsidiary" if (i) the subsidiary engages only in "activities that are permissible for a national bank to engage in directly either as a part of, or incidental to, the business of banking," and (ii) the parent bank "controls" the subsidiary (typically by owning more than 50% of the subsidiary's voting stock). 12 C.F.R. §§ 5.34(e)(1) &(2).

laws that is equivalent to the "field preemption" regime established by the Office of Thrift Supervision ("OTS") for federal savings associations and their operating subsidiaries. The OCC claims that it possesses the same authority to override state laws that the OTS has asserted in its own regulations.[9]

In its second rulemaking notice, the OCC amended Section 7.4000 of its regulations, which restricts the exercise of "visitorial powers" over national banks.[10] The preamble to this amendment asserts that "Federal law commits the supervision of national banks' Federally-authorized banking business *exclusively* to the OCC (except where Federal law provides otherwise) . . . ."[11] The amended rule bars state officials from suing in federal or state courts to require national banks to comply with state laws. According to the OCC, state officials will be allowed only to seek a declaratory judgment as to whether a particular state law applies to national banks. Even if a state official obtains a court order declaring that a state law *does* apply to national banks, the amended rule gives the OCC sole discretion to decide *whether* to enforce that law against a national bank.[12] The preamble also declares that, by virtue of Section 7.4006

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[9] *See* OCC Docket 04-04, *supra* note 3, at 1914 (stating that "the preemption regulations adopted by the OCC are substantially identical to the preemption regulations of the OTS"); Off. Comptr. Curr., Preemption Final Rule, Questions and Answers, at 3-4 (Jan. 7, 2004), *available at* http://www.occ.treas.gov (asserting that the OCC's rulemaking authority is "comparably broad to that of the OTS"). The OTS has proclaimed that its regulations "occup[y] the field" with respect to the deposit-taking and lending activities and other "operations" of federal savings associations. *See* 12 C.F.R. §§ 557.11, 560.2 & 545.2.

[10] *See* Bank Activities and Operations, 69 Fed. Reg. 1895 (issued Jan. 7, 2004) (amending 12 C.F.R. § 7.4000) [hereinafter "OCC Docket 04-03"].

[11] *Id*. at 1895 (emphasis added).

[12] *See id.* at 1899-900.

of the OCC's regulations,[13] amended Section 7.4000 will "prevent states from exercising visitorial authority over national bank operating subsidiaries."[14] Thus, the OCC asserts that it possesses *sole and exclusive authority* to enforce applicable state laws against national banks *and* their operating subsidiaries, whether by administrative or judicial proceedings.[15]

Unless the OCC's new preemption and visitorial powers rules are overturned by Congress or the courts, the rules will destroy the competitive balance between state and national banks that Congress has long maintained within the dual banking system. In addition, the OCC's rules regarding operating subsidiaries will seriously infringe upon the states' authority to regulate state-chartered corporations and to protect consumers from illegal, fraudulent and unfair financial practices. The remainder of my testimony sets forth a number of reasons why the OCC does *not* have authority to adopt its new rules. Following is a brief summary of those reasons.

First, the OCC's attempt to create a regime of de facto "field preemption" is contrary to a long line of decisions issued by the U.S. Supreme Court and other courts. Those decisions have consistently upheld the principle that "federally chartered banks are subject to state law."[16] Based on that principle, the courts have required national banks to comply with applicable state laws *except* in situations where such laws "prevent or *significantly* interfere with" the ability of national banks to exercise their congressionally-authorized powers.[17]

Second, Congress has repeatedly acted during the past century to preserve the dual

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[13] 12 C.F.R. § 7.4006.

[14] OCC Docket 04-03, *supra* note 10, at 1900.

[15] *See id.* at 1897-900.

[16] *Atherton v. FDIC,* 519 U.S. 213, 222 (1997).

[17] *Barnett Bank of Marion County, N.A. v. Nelson,* 517 U.S. 25, 33 (1996).

banking system by maintaining a competitive equilibrium between national and state banks in the most important areas of banking operations. When it passed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994,[18] Congress reiterated its support for core principles of the dual banking system, including the presumptive application of state laws to national banks. The House-Senate conference report on the Riegle-Neal Act declared that (i) "States have a legitimate interest in protecting the rights of their consumers, businesses and communities," (ii) "States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, *regardless of the type of charter an institution holds*," and (iii) "[u]nder well-established judicial principles, *national banks are subject to State law in many significant respects*."[19] In adopting the Gramm-Leach-Bliely Act of 1999, Congress expressly endorsed the "prevent or significantly interfere with" test for preemption that the Supreme Court established in *Barnett Bank*.[20] In view of this explicit congressional support for the application of state laws to national banks, the OCC's rules clearly exceed the agency's authority.

Contrary to Congress' clear intent, the OCC's regulations disrupt the competitive balance that has long existed between national and state banks, and also impair the states' ability to protect consumers. The OCC's rules assert that national banks are exempt from a broad range of state laws, including those dealing with fair lending and consumer protection. Unless the OCC's rules are overturned, large state-chartered banks that operate across state lines will have strong

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[18] Act of Sept. 29, 1994, Pub. L. No. 103-328, 108 Stat. 2338 [hereinafter "Riegle-Neal Act"].

[19] H.R. Rep. No. 103-651, at 53 (Conf. Rep.), *reprinted in* 1994 U.S. Code Cong. & Ad. News 2068, 2074.

[20] Act of Nov. 12, 1999, Pub. L. No. 106-102, 113 Stat. 1338 [hereinafter "GLBA"], § 104(d)(2)(A), 113 Stat. 1353 (codified at 15 U.S.C. § 6701(d)(2)(A)).

incentives to convert to national charters to avoid the application of state laws. Over time, it seems likely that the state banking system will be reduced to a group composed primarily of small, community-based banks, while the national banking system will be increasingly dominated by large, multistate banks. As a consequence, even if the state regulatory system can survive as a chartering authority for community banks, there will no longer be a meaningful chartering option for most banks. Such an outcome would severely weaken the dual banking system's current incentives for regulatory innovation and flexibility.

Third, the OCC does not have authority under 12 U.S.C. § 371(a) to bar the states from regulating real estate loans made by national banks. Under § 371(a), the OCC's rulemaking power with regard to real estate loans is expressly limited by the uniform standards for real estate lending adopted by the federal banking agencies pursuant to 12 U.S.C. § 1828(o). Those uniform interagency standards require all banks insured by the Federal Deposit Insurance Corporation ("FDIC")—*including* national banks—to comply with "all real estate related laws and regulations," a phrase that on its face includes applicable state laws.[21] The uniform standards are consistent with judicial decisions that have upheld the application of state laws to real estate transactions by national banks, *except* in cases involving a direct conflict between a state law and a federal statute or authorized regulation. Accordingly, the OCC's far-reaching preemption rules for real estate loans are not authorized by § 371(a).

Fourth, the OCC also lacks authority to create a regime of de facto "field preemption" for the non-real estate transactions of national banks, such as the acceptance of deposits and the

[21] *See infra* notes 33-34 and accompanying text (discussing the interagency uniform standards established under 12 U.S.C. § 1828(o), governing real estate loans made by *all* FDIC-insured depository institutions).

making of unsecured loans. Decisions of the Supreme Court and lower courts have held that state laws *do* apply to such transactions, *except* in cases where state law creates an irreconcilable conflict with federal law. Under 12 U.S.C. § 93a, the OCC has no authority to adopt rules that expand the powers or immunities of national banks by preempting applicable state laws. The OCC also cannot rely on the OTS' broad claims of preemptive power. The courts have consistently held that the OCC's authority to override state laws is far more circumscribed than the OTS' comparable power. Accordingly, the OCC's preemption rules for non-real estate transactions are unlawful.

Fifth, the OCC cannot prevent state officials from filing lawsuits to enforce applicable state laws against national banks. Federal and state courts have held that 12 U.S.C. § 484(a) authorizes state officials to obtain compulsory judicial remedies to stop violations of state laws by national banks. In addition, federal statutes do not restrict the authority of state officials to use administrative or judicial measures to enforce state laws against operating subsidiaries of national banks. State enforcement has proven to be a highly effective and necessary supplement to federal efforts to protect the public against illegal, fraudulent, and unfair practices by consumer lenders, securities firms and mutual funds. National banks and their affiliates have been implicated in abusive practices in all three areas.

Sixth, the OCC lacks authority to apply its preemption and visitorial powers rules to operating subsidiaries of national banks. The OCC does not have power to bar the states from licensing, examining and otherwise regulating state-chartered corporations that are subsidiaries of national banks. Federal banking statutes and state corporate laws establish a clear legal separation between national banks and their "affiliates," including their operating subsidiaries.

Operating subsidiaries are chartered as separate and distinct corporate entities under the authority of state law. Because they are creatures of state law, operating subsidiaries must comply with all applicable state requirements. The OCC's rules effectively "federalize" state-chartered subsidiaries by placing them under the exclusive supervisory control of the OCC. The OCC has no authority to take such a radical step under § 484(a) or any other federal statute. Indeed, the OCC's rules create serious constitutional questions under the Tenth Amendment, because they infringe upon the sovereign power of the states to regulate corporations chartered under state law.

Finally, public policy does not favor entrusting the OCC with sole discretion and authority to enforce consumer protection laws against national banks and their operating subsidiaries. Virtually the entire OCC budget is funded by national bank fees, and the biggest national banks pay the highest assessment rates. The OCC therefore has an obvious self-interest in pursuing a preemption agenda that will encourage large, multistate banks to operate under national charters. In addition, during the past decade the OCC has not issued a single public enforcement order against any of the nine largest national banks for violating a consumer protection law. The OCC's unimpressive enforcement record is, unfortunately, consistent with its strong budgetary interest in maintaining the loyalty of leading national banks. Given the OCC's financial self-interest and its empire-building agenda, the OCC faces a clear conflict of interest (and the risk of regulatory capture) whenever the agency considers the desirability of (i) preempting state consumer protection laws or (ii) taking vigorous enforcement measures against one of its most important regulated constituents.

A. The OCC's Preemption Rules Exceed the Agency's Authority, Because They Are Inconsistent with Controlling Judicial Authorities and Congressional Intent

1. State Laws Apply to National Banks Except in Situations Where a State Law "Prevents or Significantly Interferes with" a Congressionally-Authorized Power of National Banks

The OCC asserts that "the exercise by Federally-chartered national banks of their Federally-authorized powers is ordinarily *not* subject to state law."[22] That assertion is clearly wrong, because it violates core principles of federalism embodied in our dual banking system. Under the dual banking system, the states have authority to regulate the business activities of *all* banks, including national banks, *except* in specific areas where Congress has affirmatively chosen to preempt state laws.[23] In 1997, the Supreme Court reaffirmed the basic principle that "federally chartered banks are subject to state law." *Atherton v. FDIC,* 519 U.S. at 222. As support for that principle, the Court cited prior decisions reaching back more than a century to an 1870 case, where the Court declared that national banks

> . . . are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when State law incapacitates the [national] banks from discharging their duties to the federal government that it becomes unconstitutional.[24]

In *Barnett Bank of Marion County, N.A. v. Nelson,* 517 U.S. at 33, the Supreme Court

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[22] OCC Docket 03-16, *supra* note 3, at 46120 (emphasis added).

[23] For example, in *Beneficial National Bank v. Anderson,* 123 S. Ct. 2058 (2003), the Supreme Court held that 12 U.S.C. §§ 85 & 86 provide "an *exclusive* federal cause of action for usury against national banks." Id. at 2064 (emphasis added). Thus, usury is a *specific* area where Congress has determined that state-law rules should *not* apply to national banks. However, as shown below, Congress has *not* delegated to the OCC any preemptive rulemaking authority that would allow the OCC to give national banks and their operating subsidiares a *general* immunity from state regulation.

[24] *National Bank v. Commonwealth,* 76 U.S (9 Wall.) 353, 362 (1870), quoted in *Atherton,* 519 U.S. at 222-23.

held that a state may not "forbid, or impair significantly, the exercise of a power that Congress explicitly granted" to national banks." However, immediately following that statement, the Court explained that "[t]o say this is *not* to deprive States of the power to regulate national banks, where . . . doing so *does not prevent or significantly interfere with* the national bank's exercise of its powers." Id. (emphasis added). The Supreme Court also made clear that the National Bank Act, 12 U.S.C. § 21 *et seq.* ("NBA"), does *not* create a regime of field preemption. Accordingly, state laws are preempted *only* when they create an "irreconcilable conflict" with federal statutes governing the activities of national banks. Id. at 31. When Congress adopted Section 104 of GLBA in 1999, Congress specifically endorsed the "prevent or significantly interfere with" test for preemption established in *Barnett Bank*.[25]

In *Barnett Bank* and *Atherton,* the Supreme Court cited several prior decisions requiring national banks to comply with state laws that did *not* create any direct conflict with federal statutes.[26] In those decisions, the Court affirmed that "national banks are subject to state laws unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions."[27] Similarly, the Third Circuit Court of Appeals held in 1980 that Congress has *not* "regulate[d] national banks to the exclusion of state control," and "congressional support remains for dual regulation."[28] Fourteen years later, Congress strongly

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[25] *See* 15 U.S.C. § 6701(d)(2)(A); *see also* H.R. Rep. No. 106-434, at 156-57 (1999) (Conf. Rep.), *reprinted in* 1999 U.S. Code Cong. & Ad. News 245, 251.

[26] *See Barnett Bank,* 517 U.S. at 33-34; *Atherton,* 519 U.S. at 222-23.

[27] *Anderson National Bank v. Luckett,* 321 U.S. 233, 248 (1944). *Accord, e.g., Lewis v. Fidelity & Deposit Co.,* 292 U.S. 559, 564-66 (1934); *First National Bank in St. Louis v. Missouri,* 263 U.S. 640, 656-59 (1924); *McClellan v. Chipman,* 164 U.S. 347, 356-61 (1896).

[28] *National State Bank v. Long,* 630 F.2d 981, 985 (3d Cir. 1980). *Accord, e.g., Best v. U.S. National Bank,* 739 P.2d 554, 560-61 (Ore. 1987); *Perdue v. Crocker National Bank,* 702 P.2d 503, 520 (Cal. 1985), *appeal dism'd,* 475 U.S. 1001 (1986); *Video Trax, Inc. v.*

reiterated its approval for the general application of state laws to national banks when it passed the Riegle-Neal Act. The conference report on the Riegle-Neal Act declared:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, *regardless of the type of charter an institution holds.* In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities. . . .
>
> Under well-established judicial principles, *national banks are subject to State law in many significant respects.* . . . Courts generally use a rule of construction that *avoids finding a conflict between the Federal and State law where possible.* The [Riegle-Neal Act] does not change these judicially established principles.[29]

As shown by the conference report's endorsement of "judicially established principles" affirming that "national banks are subject to State law in many significant respects," the conferees fully agreed with prior federal court decisions such as *Commonwealth, McClellan*, *St. Louis, Luckett* and *Long*.[30] In addition, members of Congress determined that the application of

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NationsBank, N.A., 33 F. Supp. 2d 1041, 1048 (S.D. Fla. 1998), *aff'd,* 205 F.3d 1358 (11th Cir.) (per curiam), *cert. denied,* 531 U.S. 822 (2000).

[29] H.R. Rep. No. 103-651 (Conf. Rep.), at 53 (1994) (emphasis added), reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074.

[30] A recent decision by the Ninth Circuit Court of Appeals held that "the presumption against preemption of state law is inapplicable" in determining whether national banks must comply with state law. *Bank of America v. City and County of San Francisco,* 309 F.3d 551, 558-59 (9th Cir. 2002), *cert. denied,* 123 S. Ct. 2220 (2003). The Ninth Circuit contended that its refusal to apply a presumption in favor of state banking laws was consistent with the Supreme Court's decision in *United States v. Locke,* 529 U.S. 89 (2000). However, the Ninth Circuit's reliance on *Locke* was clearly misplaced. In *Locke,* the Supreme Court declined to apply an "an 'assumption' of non-preemption" when it struck down state laws that imposed restrictions on oil tankers operating in navigable waterways. The Supreme Court emphasized in *Locke* that the challenged state laws sought to regulate "national and international maritime commerce" – an area in which Congress had shown a clear desire to establish "a *uniformity of regulation*." 529 U.S. at 108 (emphasis added). By contrast, in *Atherton,* after reviewing the long history of state regulation of national banks, the Supreme Court held that federal policy did *not* require any "uniformity" of regulatory treatment for federally-chartered banks. Accordingly, the Court refused in *Atherton* to adopt a federal common-law rule for federally-chartered banks that would override state-law standards. 519 U.S. at 219-26. Similarly, the Supreme Court has made clear

state laws to national banks in four broadly-defined areas – community reinvestment, consumer protection, fair lending and intrastate branching – was essential in order to safeguard consumers and preserve the vitality of the dual banking system.[31] As explained below in Part D, Congress' action in the Riegle-Neal Act was consistent with a series of federal statutes enacted since 1910. In those statutes, Congress has clearly expressed its desire to maintain a competitive equilibrium within the dual banking system, achieved in large measure through the application of state laws to national banks.

In view of the federalism policies embodied in the dual banking system, the OCC's new preemption rules clearly exceed the agency's authority under the NBA and are invalid. Federal courts and Congress have repeatedly made clear that state laws *do* apply to national banks *except* in situations where a particular state law "prevents or *significantly* interferes with" a federally-authorized power of national banks. The OCC's new preemption rules – which

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that the application of state law to national banks is "the rule," while preemption is "the exception." *McClellan,* 164 U.S. at 357; *St. Louis,* 263 U.S. at 656.

[31] The Riegle-Neal Act requires local branches of out-of-state national banks to comply with nondiscriminatory host state laws in the four designated areas, except where federal law preempts the application of such state laws to national banks. *See* 12 U.S.C. § 36(f); *see also* 140 Cong. Rec. H 6775 (daily ed. Aug. 4, 1994) (remarks of Rep. Neal, explaining that the Riegle-Neal Act "respects States' rights by . . . ensur[ing] that certain State laws will continue to apply to interstate branches of national banks"); id. at H 6777 (remarks of Rep. Roukema, stating that "[t]he dual banking system and States' rights are preserved in that the [Riegle-Neal Act] . . . preserves the States' ability to apply State laws regarding intrastate branching, fair lending and consumer protection"); id. at H 6782 (remarks of Rep. LaFalce, explaining that "[t]his legislation fully recognizes the crucial role State play in regulating financial institutions within their borders and particularly in protecting consumers"); 140 Cong. Rec. S 12784 (daily ed. Sept. 13, 1994) (remarks of Sen. Ford, declaring that the Reigle-Neal Act "has been carefully structured in a manner which protects important States' rights under our dual banking system"); id. at S 12787 (remarks of Sen. Dodd, stating that the Riegle-Neal Act "strikes the proper balance between creating a more efficient national banking system and protecting States rights and the dual banking system . . . [by] requiring branches to abide by applicable State laws").

override *all* state laws that do anything beyond providing "the legal infrastructure that makes it practicable" for national banks to function – are radically inconsistent with the preemption standards that have been established by the courts and endorsed by Congress.[32]

2. The OCC's Preemption Rules Clearly Exceed Its Rulemaking Authority

The OCC does not possess any substantive rulemaking power that would justify its new preemption rules. Under 12 U.S.C. § 371(a), as amended in 1991, national banks may make real estate loans "subject to section 1828(o) of this title and such restrictions and requirements as the [OCC] may prescribe by regulation or order." Thus, as the OCC concedes, national banks must comply with the uniform standards for real estate loans that the federal banking agencies have adopted under 12 U.S.C. § 1828(o).[33] Section 1828(o) ensures that all FDIC-insured depository

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[32] In its new preemption rules (OCC Docket 04-04, *supra* note 3, at 1910 & n.53), the OCC cites the Supreme Court's use of the word "condition" in *Barnett Bank*. In the relevant passage, the Court said that "where Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies." 517 U.S. at 34. Read in context, the Court was clearly saying that a state may not seek to *prohibit* the use of a federal power by requiring national banks to obtain the state's permission as a "condition" for exercising that power. *See* id. at 531-32 (responding to Florida's argument that "the Federal Statute removes only federal legal obstacles, not state legal obstacles, to the sale of insurance by national banks"). *Barnett Bank* did *not* say that a state may never *affect* the exercise of a federal power by requiring national banks, in the course of exercising that power, to satisfy reasonable "conditions" that all similarly-situated persons must meet. The Supreme Court had previously upheld the states' authority to place reasonable, nondiscriminatory conditions on national bank activities in both *Luckett,* 321 U.S. at 247-49, and *McClellan,* 164 U.S. at 358-59.

In its preemption rules, the OCC also tries to justify its preemption standard by citing the Supreme Court's statement that a state law will be preempted when it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." OCC Docket 04-04, *supra* note 3, at 1910 & nn.50-51 (quoting and citing *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941). However, in light of the congressional policies embodied in the dual banking system, it is the *OCC's rules* that actually "create an obstacle" to the achievement of Congress' true purposes for the U.S. banking industry.

[33] *See* OCC Docket 04-04, *supra* note 3, at 1909-10 & n.41.

institutions have an equal competitive opportunity to make real estate loans based on uniform interagency standards, which cannot be altered unless they are "uniformly amended" by *all* of the federal banking agencies.

Section 371(a) permits the OCC to issue rules imposing *additional* "restrictions and requirements" on real estate loans, but the OCC may *not* exempt national banks from the uniform standards established under § 1828(o). One of those uniform standards requires all FDIC-insured institutions – *including* national banks – to adopt policies designed to ensure "[c]ompliance with *all real estate related laws and regulations.*"[34] On its face, this standard includes applicable *state* laws and regulations. When Congress adopted the Riegle-Neal Act in 1994 – just three years after amending § 371(a) – Congress clearly understood that the states *did* have authority to regulate real estate loans made by national banks. As noted above, the Riegle-Neal Act included a provision that generally requires branches of out-of-state national banks to comply with host state laws in the areas of community reinvestment, consumer protection and fair lending. *See* 12 U.S.C. § 36(f). Congress would hardly have included this statutory expression of support for the application of state laws to national banks' real estate loans – consistent with the decision in *Long*[35] – if Congress had contemplated that the OCC could use § 371(a) to preempt *all* state regulation of real estate lending by national banks.

The OCC also does not possess any independent power to preempt state laws under 12 U.S.C. § 93a. Under § 93a, the OCC may issue regulations "to carry out the responsibilities of

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[34] *See, e.g.,* 12 C.F.R. Part 34, Subpart D, App. A (uniform standards applicable to national banks, under the heading "LOAN PORTFOLIO MANAGEMENT CONSIDERATIONS") (emphasis added).

[35] *See* 630 F.2d at 985-87 (holding that residential mortgage loans made by national banks must comply with New Jersey's anti-redlining statute).

the office." However, this rulemaking authority "carries with it no new authority to confer on national banks powers which they do not have under existing substantive law."[36] Thus, § 93a does *not* permit the OCC to "authorize activities that run afoul of federal laws governing the activities of national banks."[37] Put another way, § 93a does *not* allow the OCC to grant powers or immunities to national banks that they do not *already* possess under federal *statutory* law.

The Comptroller of the Currency himself acknowledged in 2002 that "the OCC has no self-executing power to preempt state law."[38] Comptroller Hawke observed that the OCC "has on many occasions *expressed opinions* about the preemptive effect of federal law."[39] However, in view of the narrow scope of the OCC's rulemaking power under Section 93a, that statute *cannot* provide the OCC's "opinions" with any independent preemptive force.

The OCC is also wrong in asserting that it enjoys a preemptive rulemaking power similar to that of the OTS. Under Section 5(a) of the Home Owners' Loan Act ("HOLA"), 12 U.S.C. § 1464(a), the OTS is authorized "to provide for the organization, incorporation, examination, operation, and regulation" of federal savings associations "giving primary consideration to the best practices of thrift institutions in the United States." In 1982, the Supreme Court held that Section 5(a) conferred upon the Federal Home Loan Bank Board ("FHLBB"), the OTS' predecessor agency, "plenary authority to issue regulations governing federal savings associations" – an authority which "expressly contemplated . . . the [FHLBB's] promulgation of

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[36] 126 Cong. Rec. 6902 (1980) (remarks of Sen. Proxmire), quoted in *Conf. of State Bank Supervisors v. Conover,* 710 F.2d 878, 885 (D.C. Cir. 1983).

[37] *CSBS v. Conover,* 710 F.2d at 885.

[38] Speech by Comptroller of the Currency John D. Hawke, Jr. on Feb. 12, 2002, reprinted in OCC News Release 2002-10, at 7, *available at* www.occ.treas.gov).

[39] Id. (emphasis added).

regulations superseding state law."[40] In reaching this decision, the Supreme Court placed great weight on Congress' apparent decision to allow the FHLBB to implement what it believed were the "best practices" of thrift institutions, regardless of state law.[41] In contrast, there is no comparable provision in the NBA that allows the OCC to define the "best practices" of national banks or to preempt state laws that the OCC believes are in conflict with those "best practices."

As I discuss in my forthcoming article, the question of whether the OTS possesses unlimited "field preemption" authority under HOLA has not yet been resolved by the courts.[42] Regardless of the precise scope of the OTS' preemptive authority under HOLA, it is clear that the OCC does *not* possess any comparable power. As shown above, Sections 371(a) and 93a do *not* give the OCC any "plenary" rulemaking power similar to that conferred on the OTS by Section 5(a) of HOLA. The courts have consistently held that the OTS' ability to preempt state laws is far greater than any comparable power possessed by the OCC under the NBA. For example, in *People v. Coast Federal Savings & Loan Association,*[43] the district court held that HOLA authorized the FHLBB to issue "comprehensive rules and regulations concerning the powers and operations of every Federal savings and loan association from its cradle to its corporate grave."[44] The court also declared that the preemptive reach of HOLA is far greater than that of the NBA:

> [A] building and loan association organized under [HOLA] is not a national bank and the powers and duties of the two materially differ. *As to national banks, Congress expressly left open a field for state regulation and the application of state laws;* but as to federal savings and loan associations, Congress made plenary, preemptive delegation to the [FHLBB] to organize, incorporate, supervise

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[40] *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 160, 162 (1982).
[41] *Id.* at 161-62.
[42] *See* Wilmarth, *OCC Preemption Rules, supra* note 2, Parts III.B.2 & III.F.2.
[43] 98 F. Supp. 311 (S.D. Cal. 1951).
[44] Id. at 316.

and regulate, leaving no room for state supervision.[45]

This statement in *Coast Federal* is highly significant, because subsequent court decisions have quoted *Coast Federal*'s "cradle-to-grave" metaphor in describing the expansive authority held by the FHLBB and the OTS.[46]

Similarly, in *North Arlington National Bank v. Kearny Federal Savings & Loan Association,*[47] the court held that the NBA could *not* be used as an "analogy" in discussing the authority granted to the FHLBB under HOLA, because of "the historical reasons back of the establishment of national banks and the *altogether different type of administrative control exercised over them.*"[48] Two other federal appellate decisions establish the same clear distinction between the broad preemptive authority of the OTS and the much more circumscribed power of the OCC.[49]

In light of the foregoing authorities, the OCC cannot justify its preemption rules by relying on Section 371(a), Section 93a, or the OTS' rulemaking power under HOLA. The OCC's rules violate "the clear intent of Congress," because they are contrary to extensive legislative and judicial authorities showing that "Congress could not have intended to delegate a decision of

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[45] Id. at 319 (citation and internal quotation marks omitted; emphasis added).

[46] *E.g., de la Cuesta,* 458 U.S. at 145 (quoting *Coast Federal*); *Conference of Federal Savings & Loan Ass'ns v. Stein,* 604 F.2d 1256, 1260 (9th Cir. 1979) (same), *aff'd mem.*, 445 U.S. 921 (1980); *Bank of America,* 309 F.3d at 558 (same).

[47] 187 F.2d 564 (3d Cir.), *cert. denied,* 342 U.S. 816 (1951).

[48] Id. at 567 (emphasis added).

[49] *See Long,* 630 F.2d at 989 (stating that "federal regulation of federal savings and loan associations . . . is distinct from the supervision of national banks by the [OCC] and . . . federal savings and loan associations do not have the lengthy history of dual regulation that characterizes the national banking system"); *Bank of America,* 309 F.3d at 558-59 (stating that "regulation of federal savings associations by the OTS has been so 'pervasive as to leave no room for state regulatory control'," while, in contrast, "states retain some power to regulate national banks").

such economic and political significance to [the OCC]."[50]

B. The OCC's Rule Exempting Operating Subsidiaries from State Regulation Violates Fundamental Principles of Corporate Governance and Financial Regulation

Under Section 7.4006 of its regulations, the OCC claims that operating subsidiaries of national banks are immune from state supervision. This claim ignores the unquestioned primacy of the states in regulating state-chartered corporations. The courts have repeatedly upheld the authority of each state (i) to exercise comprehensive supervision over the corporations it charters, (ii) to regulate companies chartered by other states that transact business within its borders, and (iii) regulate entities that offer financial services to its residents. With regard to locally-chartered corporations, the Supreme Court held in 1987 that:

> No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations. . . .
>
> [S]tate regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law. . . .
>
> It is thus an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. . . .[51]

With respect to corporations chartered by other states, the Supreme Court has affirmed that each state "is legitimately concerned with safeguarding the interests of its own people in business dealings with corporations not of its own chartering but who do business within its borders."[52] Each state may therefore require foreign corporations to comply with

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[50] *FDA v. Brown & Williamson*, 529 U.S. 120, 132-33, 159-61 (2000).

[51] *CTS Corp. v. Dynamics Corp. of America,* 481 U.S. 69, 89, 91 (1987). *See also Oregon Railway & Navigation Co. v. Oregonian Railway Co.,* 130 U.S. 1, 20 (1889) ("the powers of corporations . . . are such and such only, as are conferred upon them by the acts of the legislatures of the several States under which they are organized").

[52] *Union Brokerage Co. v. Jensen,* 322 U.S. 202, 208 (1944).

nondiscriminatory licensing requirements and other regulations enacted "for the purpose of insuring the public safety and convenience."[53]

Courts have also emphasized the longstanding policy of Congress to refrain from adopting a "federal corporate law" that would "overturn or at least impinge severely on the tradition of state regulation of corporate law."[54] In violation of this congressional policy, Section 7.4006 of the OCC's regulation overrides fundamental principles of state corporate law and infringes upon the states' sovereign authority to regulate state-chartered corporations. Section 7.4006 ignores the legal separation between a national bank and its operating subsidiary and (in conjunction with the OCC's other rules) obliterates the subsidiary's legal obligations under its state corporate charter. The OCC's position directly conflicts with the Supreme Court's admonition that the legal separation between a subsidiary and its parent corporation is a "general principle of corporate law deeply ingrained in our economic and legal systems."[55] Federal courts have often refused to interpret federal statutes in a manner that would ignore principles of corporate separation and other fundamental tenets of state corporate law, absent clear evidence

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[53] Id. at 211 (internal quotation marks and citation omitted).

[54] *Business Roundtable v. SEC,* 990 F.2d 406, 412 (D.C. Cir. 1990). *Accord, Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden").

[55] *United States v. Bestfoods,* 524 U.S. 51, 61 (1998) (citation and internal quotation marks omitted). *Accord, Dole Food Co. v. Patrickson*, 123 S. Ct. 1655, 1660 (2003) ("A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities"); *Minnesota v. Fleet Mortgage Corp.,* 181 F. Supp. 2d 995, 1000 (D. Minn. 2001) ("operating subsidiaries hold a separate incorporated status from their parent banks, and subsidiaries are not chartered as federal banks").

that Congress intended such a result.[56]

The OCC has itself relied on principles of corporate separation in presenting legislative proposals to Congress. During congressional hearings on GLBA, the OCC invoked the corporate separation doctrine (including the reluctance of courts to "pierc[e] the corporate veil") to support its argument that Congress should *not* be greatly concerned by the possible risk that "banks would end up being liable for the debts of their subsidiaries."[57] Having advised Congress that national banks and their subsidiaries are separate and distinct entities under corporate law, the OCC cannot claim any congressional mandate for its current claim that operating subsidiaries are "indistinguishable" from their parent national banks.[58]

In tandem with the OCC's preemption and visitorial powers rules, Section 7.4006 severely undermines the historic primacy of the states in matters of corporate regulation. Under the OCC's view, the states must surrender all authority to license, examine and supervise state-chartered corporations that are controlled by national banks. This "interpretation" of the OCC's

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[56] *E.g., Dole Food Co.,* 123 S. Ct. at 1661 (refusing to conclude that, "as a categorical matter, all subsidiaries are the same as the parent corporation," because "the text of the [relevant statute] gives no indication that Congress intended us to depart from the general rules regarding corporate formalities"); *Bestfoods,* 524 U.S. at 62 (rejecting a proposed reading of a pollution control statute ("CERCLA") that would impose automatic liability on a parent corporation for the acts of its subsidiary, because "nothing in CERCLA purports to reject this bedrock principle [of corporate separation], and against this venerable commonlaw backdrop, the congressional silence is audible"); *CTS Corp.,* 481 U.S. at 85, 86 (refusing to construe a federal statute to "pre-empt a variety of state corporate laws of hitherto unquestioned validity," because the "longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all [such] state laws . . . it would have said so explicitly"); *Business Roundtable,* 905 F.2d at 412, 415 (striking down an agency rule that would "overturn or at least impinge severely on the tradition of state regulation of corporate law," because "nothing in the statute and legislative history suggests so broad a [congressional] purpose"); *see also Santa Fe,* 462 U.S. at 479 (quoted *supra* at note 54).

[57] H.R. Rep. No. 106-74, at 101 (1999) (pt. 1) (discussing the OCC's views).

[58] OCC Docket 04-03, *supra* note 10, at 1900.

authority over operating subsidiaries is indefensible. The federal government intrudes upon the states' sovereignty and exceeds the boundaries of its own authority under the Tenth Amendment when it attempts to convert state-chartered corporations into creatures of federal law without the permission of the chartering states.[59] In a comparable case, the Supreme Court rejected a federal agency's interpretation of federal law, because the agency's position would have created "significant constitutional and federalism questions" by "permitting federal encroachment upon a traditional state power" without any "clear indication that Congress intended that result."[60] Based on the same reasoning, § 7.4006 of the OCC's rules should be declared invalid.

Section 7.4006 also ignores the states' historic role in regulating providers of financial services. Courts have repeatedly upheld the authority of each state to regulate banks and nonbanks for the purpose of protecting its economy and its citizens from unsound or fraudulent providers. In a 1980 decision, the Supreme Court declared:

> We readily accept the submission that, both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern. . . . [S]ound financial institutions and honest financial practices are essential to the health of any State's economy and to the well-being of its people. Thus, it is not surprising that ever since the early days of our Republic, the States have chartered banks and have actively regulated their

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[59] *Hopkins Federal Savings & Loan Ass'n v. Cleary,* 296 U.S. 315 (1935) (Section 5(i) of HOLA violated the Tenth Amendment, because it permitted state-chartered savings institutions to convert to federal charters, and to operate under the FHLBB's exclusive supervision, without state permission); *Chicago Title & Trust Co. v. 4136 Wilcox Bldg. Corp.,* 302 U.S. 120 (1937) (Section 77B of the federal Bankruptcy Act did not authorize the filing of a bankruptcy petition on behalf of a corporation whose charter had expired under state law, because any such filing would create "an intrusion by the Federal Government on the powers of the State" and would create serious problems under the Tenth Amendment as construed in *Hopkins*).

[60] *Solid Waste Agency of Northern Cook County v. U.S. Army Corp. of Engineers,* 531 U.S. 159, 174, 172 (2001).

activities.[61]

In the same case, the Supreme Court observed that 12 U.S.C. § 1846 "does reserve to the States a general power to enact regulations" applicable to bank holding companies and their subsidiaries, provided such "state legislation . . . operates within the boundaries marked by the Commerce Clause."[62] In the field of mortgage lending, courts have repeatedly upheld state laws designed to prevent lenders from engaging in fraud, predatory lending, redlining and other unconscionable practices.[63]

Thus, Section 7.4006 is completely inconsistent with core principles of federalism that are firmly embedded in our systems of corporate governance and financial regulation. As shown in Part C below, federal statutes do *not* permit the OCC to bar the states from exercising their traditional regulatory powers over *all* state-chartered providers of financial services.

C. The OCC Does Not Have Authority to Prevent the States from Enforcing Valid State Laws Against National Banks and Their Operating Subsidiaries

1. Section 484 Does Not Preempt the States' Authority to Enforce State Laws Against National Banks and Their Operating Subsidiaries

12 U.S.C. § 484(a) provides:

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[61] *Lewis v. BT Investment Managers, Inc.,* 447 U.S. 27, 48 (1980). *Accord, Northeast Bancorp v. Board of Governors,* 472 U.S. 159, 177-78 (1985). *See also Old Stone Bank v. Michaelson,* 439 F. Supp. 252, 256 (D.R.I. 1977) ("It has long been recognized that a state may regulate banking to protect the public welfare in the exercise of its police power").

[62] *Lewis*, 447 U.S. at 48-49. Section 1846(a) reserves to each state the power to regulate "companies, banks, bank holding companies, and subsidiaries thereof." In *Lewis,* the Supreme Court noted that the challenged Florida law was not preempted by any federal statute. Id. at 35. The Court struck down the law because it discriminated against investment advisory firms owned by out-of-state banking organizations, thereby violating the Commerce Clause. *See* id. at 31-32, 35-37, 42-44.

[63] *E.g., Long,* 630 F.2d at 985-87; *United Companies Lending Corp. v. Sargeant,* 20 F. Supp. 2d 192, 200-04 (D. Mass. 1998); *In re Maxwell,* 281 B.R. 101, 123-31 (Bankr. D. Mass. 2002); *Solomon v. Gilmore,* 731 A.2d 280, 283-89 (Conn. 1999).

> No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or shall have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

The second clause of § 484(a) expressly authorizes "the courts of justice" to exercise "visitorial powers" over national banks. As the OCC has acknowledged, federal and state courts have exercised visitorial powers over national banks ever since the NBA was enacted in 1864.[64] Based on § 484(a) and its precursors, courts have repeatedly affirmed the rights of private parties and state officials to obtain *judicial remedies* enforcing state laws against national banks.[65]

For example, in *St. Louis,* the defendant national bank and the United States claimed that Rev. Stat. § 5241 (the predecessor of § 484) barred the Attorney General of Missouri from suing to stop the bank from violating state law.[66] The Supreme Court, however, *rejected* that claim. After finding that federal law did *not* preempt the relevant state statute, the Court held that the Attorney General had full power to sue the national bank "to vindicate and enforce [Missouri's] law."[67] *St. Louis* thus conclusively establishes the authority of state officials to use *judicial*

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[64] *See* OCC Docket 04-03, *supra* note 10, at 1897-900.

[65] *E.g., First National Bank in St. Louis v. Missouri,* 263 U.S. 640, 659-61 (1924); *Guthrie v. Harkness,* 199 U.S. 148, 152-53, 157-59 (1905); *First Union National Bank v. Burke,* 48 F. Supp. 2d 132, 145-46, 148-49, 150-51 (D. Conn. 1999); *Best*, 739 P.2d at 563.

[66] *See* 263 U.S. at 642-43 (argument by bank's counsel); id. at 645-47 (argument by Solicitor General of the United States).

[67] *Id*. at 660. The OCC has asserted that *St. Louis* only allows state officials to obtain a "declaratory judgment" confirming that a state law applies to national banks. According to the OCC, the authority to seek affirmative judicial remedies to enforce state laws against national banks is a matter within the OCC's "exclusive purview." OCC Docket 04-03, *supra* note 10, at 1899-900. The OCC's position is untenable. In *St. Louis*, the Attorney General of Missouri sued under a writ of quo warranto to prevent a national bank from operating a branch that violated state law. The Attorney General obtained a judgment that "ousted [the national bank] from the privilege of operating this branch bank or any other." 263 U.S. at 655, *aff'g State ex rel. Barrett v. First Nat'l Bank of St. Louis,* 249 S.W. 619, 625 (Mo. 1923) (explaining that (i) the Attorney General proceeded in quo warranto "to prevent [the national bank] from committing an act . . .

remedies to enforce state laws against national banks.[68]

Section 484's limitation on visitorial powers applies *only* to "national banks," and the statute therefore does *not* restrict the authority of state officials to regulate operating subsidiaries of national banks. The term "national bank," as used in § 484, is governed by the definitions set forth in 12 U.S.C. §§ 221 & 221a(a). As those sections and related federal banking statutes make clear, a "national bank" is a financial institution that (i) files articles of association and an organization certificate with the OCC, pursuant to 12 U.S.C. §§ 21-24 & 26; (ii) receives from

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expressly contravening a state statute", and (ii) the judgment in quo warranto "prohibited [the national bank] by a general ouster from committing particular illegal acts"). Thus, the judicial remedy upheld in *St. Louis* was functionally equivalent to a permanent injunction and went far beyond a mere declaration of the validity of Missouri's anti-branching law. In accordance with *St. Louis,* subsequent federal court decisions have repeatedly upheld the authority of state officials to obtain prohibitory remedies – *including* injunctive relief – to prevent national banks from violating state laws. *E.g., Missouri ex rel. Kostman v. First National Bank in St. Louis,* 405 F. Supp. 733, 735 (E.D. Mo. 1975) (holding, in reliance on *St. Louis*, that a state commissioner was "entitled to injunctive relief" in order "to enforce the banking laws of the State of Missouri and to prohibit national banks from violating the state laws"), *aff'd,* 538 F.2d 219 (8th Cir.) (per curiam), *cert. denied,* 429 U.S. 941 (1976); *see also Colorado ex rel. State Banking Bd. v. First Nat'l Bank of Ft. Collins,* 540 F.2d 497, 498-99 (10th Cir. 1976), *cert. denied,* 429 U.S. 1091 (1977) (suit by State of Colorado for declaratory and injunctive relief; trial court issued a declaratory judgment based on "the Bank's assurances that it would comply with the trial court's declaratory judgment without the necessity of an injunction"); *Brown v. Clarke*, 878 F.2d 627, 629 (2d Cir. 1989) (affirming judgment in favor of a state commissioner who "brought suit in federal court seeking relief that would bar" a national bank from violating state law).

[68] *See* 263 U.S. at 661 (holding that "the nature of the remedy to be employed" by a state official to enforce a valid state law against a national bank "is a question for *state determination*") (emphasis added). Except as provided in § 484(b), state officials may not examine or take *administrative* enforcement measures (e.g., cease-and-desist actions) against national banks. *Long,* 630 F.2d at 987-89; *Burke,* 48 F. Supp. 2d at 143-50. Similarly, under 12 U.S.C. § 36(f)(1)(B), state officials may not examine or institute *administrative* enforcement proceedings against out-of-state branches of national banks. *See* 140 Cong. Rec. S 12786 (daily ed. Sept. 13, 1994) (colloquy between Sen. D'Amato and Sen. Riegle regarding § 36(f)(1)(B)). However, as made clear in *St. Louis* and the subsequent cases cited *supra* note 67, §§ 484 and 36(f) do *not* hinder the ability of state officials to obtain *judicial* remedies to enforce state laws against national banks.

the OCC a certificate of authority to carry on the "business of banking," pursuant to id. §§ 24 & 27; and (iii) must become a member of the Federal Reserve System ("FRS"), pursuant to id. § 282. Operating subsidiaries do *not* qualify as "national banks" under §§ 221 and 221a(a), because they are chartered as *nonbank* corporations under *state* law, they do *not* receive certificates of authority to conduct the "business of banking" from the OCC, and they *cannot* become members of the FRS. Accordingly, operating subsidiaries *cannot* be treated as "national banks" for purposes of § 484 and are *not* entitled to any immunity from state oversight provided by § 484.

The foregoing analysis is supported by § 221a(b), which defines "affiliate" to include "any corporation" that controls or *is controlled by* a national bank. Under the OCC's regulations, an operating subsidiary *must* be controlled by its parent national bank (*see* supra note 8). An operating subsidiary, therefore, is *always* an "affiliate" of the parent bank under § 221a(b). As confirmed by the legislative history of Section 221a and a related statute (12 U.S.C. § 52), an "affiliate" is a separate and distinct legal entity and cannot be treated as part of its parent bank.[69]

Congress' recognition of the separate legal status of "affiliates" is confirmed by 12 U.S.C. § 481. Under § 481, the OCC may examine "affiliates" of a national bank "as shall be necessary

[69] The definition of "affiliate" in § 221a(b) was enacted in 1933. *See* Act of June 16, 1933, c. 89, § 2, 48 Stat. 162 (codified as amended at 12 U.S.C. § 221a(b)). An important goal of the 1933 legislation (popularly known as the "Glass-Steagall Act") was "[t]o separate as far as possible national and [state] member banks from affiliates of all kinds." S. Rep. No. 73-77, at 10 (1933). To achieve this goal of separating national banks from their affiliates, the 1933 legislation included a provision – presently codified at 12 U.S.C. § 52 – which prohibits every national bank from (i) issuing stock certificates that purport to represent an ownership interest in any other corporation (except for a member bank or a corporation holding the national bank's premises), or (ii) conditioning the transfer of the national bank's stock on the transfer of the stock of any other corporation (with the same exceptions). *See* Act of June 16, 1933, § 18, 48 Stat. 186 (codified at 12 U.S.C. § 52); *see also* S. Rep. No. 73-77, at 9-10, 16.

to disclose fully the relations between such bank and such affiliates and the effect of such relations on the affairs of such bank." In contrast to § 481, Congress did *not* include the term "affiliates" in § 484. The only reasonable conclusion is that § 484's limitation on visitorial powers applies *only* to "national banks" and does *not* extend to their "affiliates" (including their operating subsidiaries). Unlike § 484, Congress did *not* insert in § 481 any restriction on the authority of state officials to exercise visitorial powers over "affiliates" of national banks. Again, the only reasonable conclusion is that § 481 does *not* restrict the authority of states to regulate "affiliates."[70] Read together, §§ 481 and 484 clearly show that Congress has *not* preempted the authority of state officials to supervise operating subsidiaries of national banks.

Congress enacted 12 U.S.C. §§ 371c & 371c-1 to regulate transactions between national banks and their "affiliates." Both sections specifically exempt operating subsidiaries from being treated as "affiliates" of their parent banks, unless the FRB decides to cancel that exemption in a particular case. Id. §§ 371c(b)(2)(A) & 371c-1(d)(1). There would be no reason for Congress to include this *specific* exemption for operating subsidiaries in §§ 371c and 371c-1, *unless* Congress understood that operating subsidiaries are *generally* treated as "affiliates" of their parent banks under § 221a(b). The OCC's claim that operating subsidiaries can be treated as "incorporated departments of the bank itself"[71] must be rejected, because the OCC's position (i) obliterates the careful distinction that Congress has drawn between national banks and their "affiliates" in § 221a, and (ii) reduces the special exemption for operating subsidiaries in §§ 371c and 371c-1 to

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[70] *See Chicago v. Environmental Defense Fund,* 511 U.S. 328, 338 (1994) (holding that "it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statue but omits it in another") (internal quotation marks and citation omitted).

[71] OCC Docket 04-03, *supra* note 10, at 1900.

the status of "meaningless . . . surplusage."[72]

The OCC's claim of "exclusive visitorial authority" over operating subsidiaries also runs afoul of *Minnesota v. Fleet Mortgage Corp.,* 181 F. Supp. 2d 995 (D. Minn. 2001). In that case, the court *rejected* the OCC's claim of "exclusive jurisdiction" over an operating subsidiary of a national bank. The court determined that the operating subsidiary, which was engaged in mortgage lending, was *not* "itself a bank" for purposes of § 133(a) of GLBA.[73] Based on that determination, the court held that (i) the OCC did *not* have "exclusive jurisdiction" to enforce laws applicable to the operating subsidiary, and (ii) the operating subsidiary was subject to the shared enforcement jurisdiction of the Federal Trade Commission ("FTC") and state officials under the FTC's Telemarketing Sales Rule.[74]

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[72] *Indep. Ins. Agents of America, Inc. v. Hawke,* 211 F.3d 638, 643-44 (D.C. Cir. 2000). *See also Board of Governors v. Investment Co. Institute,* 450 U.S. 46 (1981) ("*FRB v. ICI*"), at 58-59 n.24 (finding that the "structure of the Glass-Steagall Act . . . reveals a congressional intent to treat banks separately from their affiliates," and rejecting a proposed interpretation of that Act which would cause one of its sections, dealing with "affiliates," to become "meaningless"); *American Textile Mfrs. Institute, Inc. v. Donovan,* 452 U.S. 490, 513 (1981) (rejecting a proposed interpretation that would make one provision of a statute "nugatory, thereby offending the well-settled rule that all parts of a statute, if possible, are to be given effect").

[73] GLBA § 133(a), 113 Stat. 1383 (reprinted in 15 U.S.C.A. § 41 note). Section 133(a) of GLBA provides that the FTC has authority to enforce provisions of the FTC Act with respect to any "person" that controls, is controlled by or is under common control with a bank or savings association, as long as that "person . . . is not itself a bank or savings association." *Id.* Congress determined that § 133(a) was needed to clarify the FTC's enforcement authority with respect to affiliates of banks and savings associations, because the FTC Act exempts "banks" and "savings associations" from the FTC's jurisdiction. *See* 15 U.S.C. § 45(a)(2); *see also* H.R. Rep. No. 106-74, at 137 (1999); H.R. Rep. No. 106-434, at 161-62 (1999) (Conf. Rep.), *reprinted in* 1999 U.S. Code Cong. & Ad. News 245, 256-57.

[74] *See* 181 F. Supp. 2d at 997-1001. In rejecting the OCC's claim of "exclusive jurisdiction," the court declared:

> The OCC's insistence that it must have exclusive jurisdiction over [operating] subsidiaries in order to avoid having its authority "restricted" is not persuasive. . . . Congress simply chose *not* to provide exclusivity to the OCC in the GLBA.

The court in *Fleet Mortgage* concluded that § 133(a) of GLBA – which incorporates the definition of "bank" under 12 U.S.C. § 1813 – is "unambiguous" and "simply does not include subsidiaries of banks."[75] The court also determined that an operating subsidiary "fits precisely into the category of entities described in the language of § 133 as an entity controlled by a bank that is *not itself a bank* according to the prescribed definition."[76] The definitions of "bank" and "affiliate" in § 1813, which the court construed in *Fleet Mortgage,* are substantially identical to the definitions of the same terms in 12 U.S.C. §§ 221 & 221a.[77] Thus, the decision in *Fleet Mortgage* squarely contradicts the OCC's argument that operating subsidiaries can be treated as "national banks" for purposes of § 484.[78]

2. Sections 24(Seventh) and 24a Do Not Preempt the Authority of States to Regulate Operating Subsidiaries of National Banks

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> *There is no direct authority establishing exclusive jurisdiction over national bank operating subsidiaries,* and . . . there is no compelling reason to believe that [allowing the FTC and the states to exercise] concurrent jurisdiction would "produce a result demonstrably at odds with the intentions of [Congress]".

Id. at 1001-02 (emphasis added; citations and footnotes omitted).

[75] Id. at 1000.

[76] Id. (emphasis added).

[77] Compare 12 U.S.C. §§ 1813(a)(1)(A) (defining "bank") & 1813(w)(6) (incorporating the definition of "affiliate" from id. § 1841(k)), with id. §§ 221 & 221a(a) & (b).

[78] In contrast to *Fleet Mortgage,* a federal district court in California has deferred to the OCC's position in two recent decisions holding that state officials cannot regulate state-chartered operating subsidiaries of national banks. *National City Bank v. Boutris,* 2003 WL 21536818 (E.D. Cal., July 2, 2003) (Burrell, J.); *Wells Fargo v. Boutris,* 265 F. Supp.2d 1162, 1165-70 (E.D. Cal. 2003) (Burrell, J.). However, the California court did not consider the clear distinction that Sections 221, 221a, 371c, 371c-1, and 481 draw between "national banks" and their "affiliates" (including operating subsidiaries). In addition, the court did not mention the *Fleet Mortgage* decision. Finally, the court did not consider the drastic impact that the OCC's position would likely have in undermining the traditional authority of the states to regulate state-chartered corporations and state-licensed providers of financial services. For all these reasons, I believe that the California court clearly erred in deferring to the OCC's claim of "exclusive visitorial powers" over operating subsidiaries.

The OCC has asserted that 12 U.S.C. §§ Section 24(Seventh) and 24a support its claim of exclusive supervisory authority over operating subsidiaries of national banks.[79] However, those statutes do not express any congressional purpose to bar the states from regulating operating subsidiaries of national banks. Under § 24(Seventh), a "national banking association" has authority "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking." Like § 484(a), § 24(Seventh) refers *only* to "national banking associations" and does *not* grant any explicit authority or immunity to "affiliates."[80] Section 24(Seventh) may allow national banks to establish operating subsidiaries, but it contains no language preempting the authority of states to regulate such entities.

The fourth sentence of the first proviso of § 24(Seventh) declares: "Except as hereinafter provided *or otherwise permitted by law,* nothing herein contained shall authorize the purchase by the [national bank] for its own account of any shares of stock of any corporation" (emphasis added). Thus, national banks do *not* have power under § 24(Seventh) to make investments in subsidiaries in violation of applicable "law" – a term whose plain meaning encompasses state law – *unless* the bank can point to a specific, overriding grant of authority under a federal statute.[81] Unlike other types of subsidiaries, operating subsidiaries do *not* derive their authority

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[79] *See* OCC Interpretive Letter No. 957, Jan. 27, 2003, from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel [hereinafter "OCC IL 957"], at 6.

[80] *See FRB v. ICI,* 450 U.S. at 58 n.24 (observing that § 24(Seventh) "by its terms applies only to banks," while "[o]rganizations affiliated with banks . . . are dealt with by other sections of the [Glass-Steagall] Act").

[81] *See Video Trax,* 33 F. Supp. 2d at 1047-49, 1058 (holding that 12 U.S.C. § 24 does *not* preempt state laws from applying to national banks, unless those laws conflict with a specific provision of federal law); *Best,* 739 P.2d at 560-61 (same); *Perdue,* 702 P.2d at 520-23 (same).

from any *specific* statutory grant.[82] Accordingly, the first proviso of § 24(Seventh) indicates a congressional understanding that operating subsidiaries must generally comply with applicable state laws.

Under established canons of statutory construction, § 24(Seventh)'s general grant of "incidental powers" to national banks must be construed in a manner that is consistent with Sections 221, 221a, 371c, 371c-1, and 481, which specifically deal with "affiliates."[83] As shown above in Part C(1), those statutes demonstrate that Congress has *not* preempted the authority of state officials to regulate operating subsidiaries of national banks.

The OCC has also cited Section 121 of GLBA, codified at 12 U.S.C. § 24a, to support its claim of "exclusive visitorial authority" over operating subsidiaries of national banks. *See* OCC IL 957, at 6. Section 24a permits national banks to establish "financial subsidiaries," which may engage in certain activities (e.g., securities underwriting and dealing) that are *not* lawful for their parent banks. Subsections (a)-(f) of Section 24a also requires national banks to satisfy several conditions (including capital requirements, managerial ratings and community reinvestment standards) in order to establish and maintain "financial subsidiaries."

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[82] The second, fourth and fifth provisos of § 24(Seventh) authorize national banks to invest in subsidiaries that (i) engage in the "safe-deposit business," (ii) provide agricultural credit, and (iii) operate as "banker's banks." Under 12 U.S.C. §§ 1861-67, national banks and FDIC-insured state banks may establish subsidiaries that operate as "bank service companies." In contrast, operating subsidiaries of national banks do *not* derive their authority from any *specific* congressional grant of power. Under the OCC's regulations, the term "operating subsidiary" is defined so that it does *not* include "a subsidiary in which the bank's investment is made pursuant to specific authorization in a statute." 12 C.F.R. § 5.34(e)(2)(i).

[83] *See Hawke,* 211 F.3d at 643-45 (holding that the general grant of "incidental powers" under § 24(Seventh) must be construed in harmony with the specific limitations on insurance powers of national banks under 12 U.S.C. § 92); *American Land Title Ass'n v. Clarke,* 968 F.2d 150, 157 (2d Cir. 1992) (same), *cert. denied,* 508 U.S. 971 (1993).

Section 24a(g)(3) provides that the term "financial subsidiary" does *not* include a subsidiary that "engages solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks." Thus, Section 24a(g)(3) simply *exempts* operating subsidiaries from having to comply with the *federal statutory requirements* imposed on financial subsidiaries under Section 24a(a)-(f). Section 24a(g)(3) is *not* a power-granting provision, and it does *not* reveal any congressional purpose to bar the states from regulating operating subsidiaries.

The Senate committee report on GLBA expressly *disclaimed* any intent to expand the powers of operating subsidiaries of national banks, because it declared: "Nothing in this legislation is intended to affect any authority of national banks to engage in bank permissible activities through subsidiary corporations." S. Rep. No. 106-44, at 8 (1999). In fact, Congress understood that Section 24a would *restrict* – not expand – the OCC's authority to define the powers of operating subsidiaries. The conference report on GLBA instructed the OCC to *rescind* a prior regulation, which allowed operating subsidiaries to conduct activities that were *not* lawful for their parent national banks. *See* H.R. Rep. No. 106-434, at 160 (1999) (Conf. Rep.), *reprinted in* 1999 U.S. Code Cong. & Ad. News 245, 255 (stating that Section 24a would "supercede and replace the OCC's Part 5 regulations on operating subsidiaries"). The OCC responded to GLBA by rescinding its prior rule and by amending 12 C.F.R. § 5.34(e) to provide that operating subsidiaries may conduct *only* those activities that are permissible for their parent national banks. *See* 65 Fed. Reg. 3157, 3160 (Jan. 20, 2000) (proposed rule); id. at 12905, 12911 (Mar. 10, 2000) (final rule). It is completely illogical for the OCC to assert that Section 24a – a statute intended to *restrict* the OCC's authority over operating subsidiaries – can somehow be construed as a grant of *additional preemptive power* to the OCC.

D. The OCC's Rules Pose a Serious Threat to the Viability of the Dual Banking System

In my forthcoming article, I describe the benefits that the dual banking system has conferred upon our economy and consumers. As discussed in my article, federal legislation has allowed significant room for diversity and rivalry between the national and state banking systems. At the same time, however, Congress has repeatedly acted to preserve an effective balance between the two systems. This interplay between competition and parity reflects a deliberate congressional purpose (1) to allow state laws to apply to national banks – through either express statutory incorporation or congressional silence – in many areas of the banking business,[84] and (2) to prevent competitive factors from becoming so "lopsided" in favor of one system that the other system is unable to make adjustments in order to reestablish a competitive equilibrium.[85]

Based on this history, the Supreme Court has identified a congressional "policy of equalization," which is designed to maintain a basic parity of competitive opportunities between national and state banks.[86] In a 1964 district court decision that was later affirmed by the Supreme Court, the district court discussed the reasons influencing Congress' decision to follow a policy of maintaining "competitive equality in at least the most important areas of competition" between national and state banks:

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[84] Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation,* 30 STAN. L. REV. 1, 15-18, 37, 39-40 (1977).

[85] WILLIAM J. BROWN, THE DUAL BANKING SYSTEM 58 (1968). For my analysis of the many actions taken by Congress since 1910 to preserve a competitive balance within the dual banking system, *see* Wilmarth, *OCC Preemption Rules, supra* note 2, Part III.B.1.

[86] *First National Bank of Logan v. Walker Bank & Trust Co.,* 385 U.S. 252, 261 (1966); *Lewis,* 292 U.S. at 564-66; see also *Atherton,* 519 U.S. at 222-23.

> [I]n order for the "dual banking system" of the United States, consisting of state chartered banks and national banks . . . to continue to function as such, there must be a competitive equality in at least the most important areas of competition between the two systems. If such were not the case, one or the other of the two types of banks, the one with the competitive weight against it, would substantially be driven out of existence, either through failures or conversions to the other class of banking.
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> Congress has recognized this need for competitive equality in a manner that protects the state banks and national banks at the same time. In many important areas of the National Bank Act, Congress has incorporated state law as the standard for national banks.[87]

In 1964, Senator A. Willis Robertson, then chairman of the Senate Committee on Banking and Commerce, explained that Congress was determined to preserve a "strong and vigorous" dual banking system by (i) maintaining an equality in branching privileges between national and state banks, and (ii) preventing "any wide discrepancies" in the other "powers and limitations" of national and state banks related to "investments, trust powers, and the like."[88]

At the same time, Senator Robertson pointed out that the dual banking system (1) does not provide "identical" powers to national and state banks, and (2) permits "diversity and experimentation" within a balanced framework ensuring that "both parts of the system are strong and effective."[89] In this way, the dual banking system has permitted states to act as "laboratories" in experimenting with new banking products, structures and supervisory approaches, and

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[87] *Commercial Security Bank v. Saxon,* 236 F. Supp. 457, 460 (D.D.C. 1964), *aff'd sub nom. First National Bank of Logan v. Walker Bank & Trust Co.,* 385 U.S. 252 (1966).

[88] Speech by A. Willis Robertson at the 62nd Annual Convention of the Nat'l Ass'n of Supervisors of State Banks, reprinted in Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 before a Subcomm. of the Senate Comm. on Banking & Currency, 89th Cong. 2d Sess. (1966) [hereinafter 1966 Senate Hearings], at 33, 36. See also Speech on June 6, 1967, by FDIC Chairman K.A. Randall before the Texas Bankers Association, quoted in BROWN, *supra* note 85, at 58 (stating that the congressional policy of "competitive equality. . . can be a constructive means whereby a healthy and dynamic banking system can be fostered").

[89] Speech by Sen. Robertson, reprinted in 1966 Senate Hearings, *supra* note 88, at 36-37.

Congress has subsequently incorporated many of the states' successful experiments into federal legislation. Examples of state innovations that were adopted by Congress include: checking accounts, bank branches, real estate loans, trust services, NOW accounts, reserve requirements, deposit insurance, adjustable-rate mortgages, automated teller machines, bank sales of insurance products, interstate electronic funds transfer systems, interstate bank holding companies, and supervisory agreements that promote cooperative oversight of multistate banking organizations by state and federal regulators.[90]

Supporters of the dual banking system argue that this record of innovation has resulted from a beneficial competition between federal and state regulators. For example, during the 1980s and early 1990s, state initiatives allowing state banks to offer securities and insurance products encouraged federal regulators to take similar actions. These state and federal regulatory reforms helped persuade Congress to enact GLBA, which removed legal barriers separating the banking industry from the securities and insurance businesses.[91]

In 1984, the Presidential Task Group on Regulation of Financial Services praised the dual banking system as "one of the finest examples of cooperative federalism in the nation's history." Based on the system's role in encouraging industry innovation and flexible supervision, the

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[90] See Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System,* 58 FORDHAM L. REV. 1133, 1155-57 (1990) [hereinafter "Wilmarth, *Dual Banking System*"]; Wilmarth, *OCC Preemption Rules, supra* note 2, Part III.B.2.; Gavin Gee, "Why the State Charter?", remarks delivered at the CSBS State Banking Summit and Leadership Conf., Nov. 6, 2003 [hereinafter Gee Remarks], *available at* www.csbs.org/events/legreg/links/Gavin-Gee.pdf; Christopher Rhoads, State Charters Said to Be Gaining Popularity, Am. Banker, May 10, 1996, at 6.

[91] ROBERT E. LITAN, WHAT SHOULD BANKS DO? 50-58 (1987); Wilmarth, *Dual Banking System*, *supra* note 90, at 1161-69, 1177-81; Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks* 2002 U. ILL. L. REV. 215 [hereinafter Wilmarth, *Transformation*], at 219-23, 318-20.

report stressed the importance of preserving a "balance of state and federal regulatory participation" as a core policy for financial regulation:

> Through the years, the existence of this "dual" federal and state system has provided a safety valve against out-dated or inflexible regulatory controls being imposed by either federal or state authorities. Acting as laboratories for change, the states have frequently developed new forms of financial services, which then spread nationally through federal action. . . .
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> There is agreement within the Administration, with no appreciable dissent elsewhere, that the dual banking system and other elements of checks and balances in the overall system must be maintained. Throughout American history no single government authority has ever been entrusted with regulatory authority over all American banks. Such an unprecedented concentration of regulatory power in the hands, ultimately, of a single individual or board could have a variety of deleterious effects, including a significant erosion of the dual banking system and a possible increased risk of unanticipated supervisory problems affecting all banks.[92]

In two recent speeches, federal bank regulators echoed the findings of the 1984 Task Group. In October 2002, Comptroller of the Currency John D. Hawke, Jr. acknowledged that the dual banking system has been viewed as "a safeguard against the dangers of regulatory hegemony and abuse – and as an incentive to regulatory responsiveness and efficiency."[93] In May 2003, FRB Governor Susan S. Bies praised "the remarkable strength of the dual banking system," and she described the benefits that the dual banking system has produced in comparison with the unitary, consolidated financial systems of other nations:

> The diversity and flexibility of our banking system are unique. Bankers can make charter choices on the basis of their business needs and particular circumstances.

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[92] Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services 43-44, 46 (1984), reprinted in Federal Banking Law Reports (CCH) No. 150, Nov. 16, 1984 (Part II).

[93] Speech by Comptroller of the Currency John D. Hawke, Jr. to the People's Bank of China on Oct. 14, 2002, at 4, quoted in OCC News Release 2002-80, at 1, *available at* www.occ.treas.gov.

> . . . Our system provides a rich menu of choices to the marketplace, encouraging financial institutions to innovate and respond dynamically to the changing needs of depositors and borrowers. Under the dual banking system states have fostered innovations that likely would not have occurred as rapidly – if at all – had only federal regulation existed. The dual banking system also helps to safeguard against regulatory excesses.
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> In short, this structure has been critical in producing a banking system that is the most innovative, responsive, and flexible in the world. U.S. banks have developed those characteristics to survive in a market economy that is subject to rapid change and periodic stress. Our banking system is thus better able to finance growth and serve customer needs and has demonstrated its ability to rebound from crises that have, from time to time, devastated more rigid [foreign] systems.[94]

My own research supports Governor Bies' conclusions. In previous articles, I have presented evidence showing that the dual banking system has fostered a decentralized, competitive and innovative banking system composed of large multistate banking organizations, midsized regional organizations and thousands of community banks. In contrast to the highly concentrated banking systems of Canada, Europe and the United Kingdom, the diverse U.S. banking industry has provided demonstrably better services at lower cost to consumers and small businesses. Moreover, U.S. banks have been world leaders in creating innovative financial products and have consistently outperformed their British, Canadian and European rivals. In my view, the unique regulatory structure created by the dual banking system has been an important factor behind the superior performance of the U.S. banking industry in both domestic and global

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[94] Speech by FRB Governor Susan S. Bies before the Conference of State Bank Supervisors, May 30, 2003, at 1, *available at* www.federalreserve.gov. *See also* Richard M. Whiting, *The New 'Tri-Partite' Banking System*, 17 BANKING POLICY REP. No. 7, April 6, 1998, at 1, 13 (stating that "the dual banking system has allowed the flourishing of the safest and most stable of all banking systems in the world" and "has encouraged excellence in regulation").

financial markets.[95]

The OCC's preemption and visitorial powers rules present a very significant threat to the competitive equilibrium that currently exists in the dual banking system. In his speech of February 12, 2002, Comptroller Hawke declared that "[t]he ability of national banks to conduct a multistate business subject to a single uniform set of federal laws, under the supervision of a single regulator, free from visitorial powers of various state authorities, is a major advantage of the national charter."[96] In a newspaper article published in early 2002, Mr. Hawke's views on preemption were described as follows:

> [Mr. Hawke] doesn't apologize for using the OCC's power to override state and local laws designed to protect consumers. Enjoying this aid provides an incentive for banks to sign up with the OCC, he says. 'It is one of the advantages of a national charter, and I'm not the least bit ashamed to promote it.'[97]

Mr. Hawke's speech and the foregoing newspaper account indicate that the OCC has decided to use preemption by agency fiat as a competitive weapon against the state banking system.

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[95] See Wilmarth, *Dual Banking System*, *supra* note 90, at 1153-59, 1177-81; Arthur E. Wilmarth, Jr., *Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks,* 77 IOWA L. REV. 957, 967-77, 1015-24, 1038-48, 1051-66, 1071-72 (1992); Wilmarth, *Transformation*, *supra* note 91, at 250-72, 293-300, 440-44.

[96] Comptroller Hawke Speech of Feb. 12, 2002, *supra* note 38, at 4.

[97] Jess Bravin & Paul Beckett, *Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers,* Wall St. J., Jan. 28, 2002, at A1 (quoting Mr. Hawke in part). Banking industry commentators agree that preemption is the most significant incentive currently offered by the OCC to induce banks to choose a national bank charter. As a prominent attorney in Washington, D.C. recently stated, "The main reason for a national charter right now is preemption, because the [annual] assessments are greater for national banks . . . . Why would you want a national charter but for the preemption authority?" Todd Davenport, *Why the OCC May Tread Lightly on Georgia Law,* Am. Banker, April 9, 2003, at 1(quoting Ronald Glancz). See also Douglas Cantor, *OCC Preempts in Ga. – and Details Policy*, Am. Banker, Aug. 1, 2003, at 1 (quoting another prominent Washington attorney, Gilbert Schwartz, who suggested that the OCC's proposed preemption rules were designed to "enhanc[e] the value of the [national bank] franchise tremendously to retain national banks who may be thinking of shifting to state charters" because of "cost advantages" enjoyed by state banks).

Many of the largest national banks have applauded the OCC's preemption rules, and the OCC's preemption efforts are widely viewed by commentators as serving the interests of big, multistate national banks.[98] The OCC has a strong incentive to persuade major banks to retain or convert to national charters, because (i) the OCC's budget is almost entirely funded by fees paid by national banks, and (ii) the biggest national banks pay the largest proportionate fees to the OCC.[99] By establishing a regime of de facto field preemption for national banks, the OCC is clearly encouraging large, multistate banks to select national charters for the purpose of avoiding the application of state laws, except for *helpful* state laws that *promote* the ability of national banks to conduct business.

By providing national banks with a blanket immunity from state regulation, the OCC's preemption rules violate the congressional policy of maintaining a competitive balance in the dual banking system. As the Third Circuit noted in *Long,* each decision preempting the application of state laws to national banks creates an incentive for state banks to convert to national charters, thereby weakening the state banking system. Accordingly, in situations where

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[98] See Todd Davenport, *Are States, OCC Near a Preemption Showdown?*, Am. Banker, Nov. 5, 2003, at 1 (reporting that "[t]o nobody's surprise, large national banking companies such as Bank of America, Wells Fargo & Co., Wachovia Corp., Bank One Corp., and National City Corp. wrote long comment letters" in support of the OCC's preemption proposals); Jathon Sapsford, *Comptroller Warns States Not to Meddle with National Banks*, Wall St. J., Aug. 1, 2003, at C1 (stating that the OCC's preemption efforts "will be welcomed by nationally chartered banks regulated by the OCC, which include big banks like Wells Fargo & Co., Bank of America Corp. and Citigroup Inc.'s Citibank").

[99] In 2002, annual fee assessments and fees for corporate applications paid by national banks funded nearly 97% of the OCC's annual budget of $413 million. *See* Speech by Comptroller Hawke on Oct. 14, 2002, *supra* note 93, at 6. In the same year, Bank of America, paid an annual fee assessment of $40 million, thereby covering about one-tenth of the OCC's annual budget. *See* Bravin & Beckett, *supra* note 97. National banks pay assessments to the OCC based on their asset size. The highest marginal assessment rate is currently paid by national banks with assets of more than $40 billion. See 12 C.F.R. § 8.2(a).

Congress has *not* established an explicit standard to govern the business conducted by national banks, the Third Circuit held that

> . . . it is reasonable to assume that Congress preferred to give the states an opportunity to develop local solutions for local problems, at least in the first instance. Moreover, if state chartered institutions were alone [left subject to state law, as a result of preemption], they would be encouraged to circumvent state law by applying for national bank charters, a development not particularly desired by Congress.[100]

Similarly, in *Commercial Security Bank,* the district court pointed out that the dual banking system depends on the maintenance of a competitive balance between national and state banks, because a significant advantage gained by either system would lead to large-scale charter conversions by banks belonging to the other system.[101]

As of mid-2003, nearly half of the 100 largest U.S. banks held state charters, as did a majority of U.S. banks with interstate branches.[102] The OCC's preemption rules provide strong incentives for these multistate, state-chartered banks to convert to national charters so that they can match the ability of multistate national banks to operate without regard to restrictive state laws. Within a decade or less, the OCC's rules are likely to induce most of the larger state-chartered banks with interstate branches to migrate to the national banking system.

If the OCC's rules are successful in reducing the state banking system to a group of smaller, community-oriented banks, it would become very difficult for state banking departments to attract and retain highly-qualified supervisory personnel, and to finance the administrative

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[100] *Long,* 630 F.2d at 987.

[101] *See Commercial Security Bank,* 236 F. Supp. at 460.

[102] See Gee Remarks, supra note 90, at 4 (reporting that, as of June 30, 2003, 44 of the nation's largest 100 banks, and 56% of all U.S. banks with interstate branches, held state charters).

costs of bank oversight. In addition, the U.S. banking system would no longer have any meaningful duality if most large banks hold national charters and most small banks hold state charters. In such a system, the hypothetical ability of a large bank to convert from a national charter to a state charter would no longer provide a strong incentive for the OCC to maintain flexible, innovative or cost-effective policies. The state system, even it could survive under such circumstances, would no longer function as a significant laboratory for innovation by larger banks. Thus, most of the current benefits of the dual banking system are likely to be destroyed by the OCC's new preemption regime.

The foregoing assumptions regarding the likely outcome of the OCC's rules are supported by the comparative experiences of the banking and thrift industries over the past three decades. At the end of 1975, state-chartered banks and state-chartered savings associations each held about forty percent of the assets of their respective industry. At the same time, state-chartered banks held about two-thirds of all commercial bank charters and state-chartered savings associations held about half of all thrift charters.[103] By mid-2003, state-chartered banks had maintained (and, perhaps, even slightly improved) their position, as they held almost three-quarters of all commercial bank charters and forty-four percent of total banking assets.[104] In contrast, by mid-2003, state-chartered savings associations held only thirteen percent of all savings association charters and less than three percent of all deposits held by savings

[103] See Scott, *supra* note 84, at 3 nn.11-13, 4 nn.15-16.

[104] See Gee Remarks, *supra* note 90, at 3. Of the 445 new banks that were organized between January 1, 2000 and June 30, 2003, 345 (or 78%) were chartered as state banks. Id. at 4. See also Fed. Deposit Ins. Corp., Summary of Deposits, National Totals by Charter Class as of June 30, 2003, *available at* www.fdic.gov/sod/sodSumReport.asp?barItem=3&sInfo [hereinafter "FDIC Summary of Deposits"] (showing that, as of June 30, 2003, 2,048 national banks held $2.3 trillion of deposits, while 5,783 state banks held $1.95 trillion of deposits).

associations.[105]

What accounts for the drastic shrinkage of the state-chartered thrift industry during 1975-2003, compared with the successful performance of the state-chartered banking system during the same period? In my view, the most likely reason for the disintegration of the state-chartered thrift system is the aggressive preemption campaign that the FHLBB began in the late 1970's, and that the OTS continued after assuming the FHLBB's functions in 1989.[106] As noted above, the OTS' current regulations declare that the OTS "occupies the field" with regard to the lending, deposit-taking and other "operations" of federal savings associations.[107] Commentators have concluded that the OTS' grant of unrestricted nationwide branching powers and the OTS' aggressive preemption of state laws have given federal savings associations major advantages over other FDIC-insured depository institutions.[108]

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[105] See FDIC Summary of Deposits, *supra* note 104 (showing that, as of June 30, 2003, 798 federal savings associations held $597 billion of deposits, while 122 state savings associations held only $18 billion of deposits).

[106] Some observers might point to the thrift debacle that occurred in 1980-94. However, as explained in my forthcoming article, statistics for thrift failures during that period do not indicate any strong linkage between the thrift disaster and the drastic decline in the *relative* position of state-chartered savings associations compared to federally-chartered thrifts. Statistics show that federally-chartered savings associations experienced a mortality rate that was roughly in proportion to their share of the thrift industry's total charters and assets at the end of 1975.

It might also be noted that the OTS gained a degree of supervisory authority over state savings associations in 1989. However, it is difficult to identify any dramatic change in regulatory structure that would account for the disappearance of most state savings associations after 1989, especially in comparison with the continued survival of state banks that are *also* subject to dual state and federal oversight. *See* Wilmarth, *OCC Preemption Rules, supra* note 2, Part III.C.2.

[107] *See supra* note 9 (citing 12 C.F.R. §§ 557.11, 560.2 & 545.2).

[108] *See, e.g.,* Ira L. Tannenbaum, *Federal Thrift Charter Popularity Continues*, 18 Banking Policy Rep. No. 3, Feb. 1, 1999, at 1; Gregory J. Lyons, *A Low-Profile Charter That Offers More Bang for the Buck,* Am. Banker, Nov. 12, 2003, at 17A.

In September 2003, J.P. Morgan Chase, the largest state-chartered bank in the nation, announced that it was applying to the OTS for permission to establish a new federal savings bank. The proposed institution would operate more than 300 of Chase's consumer credit offices located outside of Chase's home market in the New York metropolitan area. Chase explained that its new federal savings bank would be able to operate under "a single national standard and have greater flexibility in opening branches in select markets across the country."[109]

As described above, the OCC's preemption rules provide national banks with the same broad immunity from state laws that federal savings associations currently enjoy under the OTS' regulations. Chase's proposal to move its national consumer lending business into a federal thrift charter – which one critic described as "purely a legal move to preempt state laws"[110] – indicates that the OCC's preemption rules are likely to persuade most of the largest state-chartered banks to convert to national charters.

E. The OCC's Rules Significantly Interfere with the Ability of State Officials to Protect Consumers from Unlawful, Fraudulent and Abusive Practices Committed by Providers of Financial Services

In addition to undermining the dual banking system, the OCC's preemption and visitorial powers rules greatly impair the states' ability to protect consumers against illegal, fraudulent and unconscionable practices in the financial services marketplace. The OCC has stated that "we have no reason to believe that such practices are occurring in the national banking system to any significant degree."[111] However, state officials and consumer representatives have challenged

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[109] Liz Moyer, Chase Seeks FSB Charter, Hints at New Markets, Am. Banker, Sept. 11, 2003, at 1 (quoting statement issued by a Chase representative).

[110] Id. (quoting Matthew Lee, executive director of Inner City Press/ Community on the Move).

[111] OCC Docket 04-04, *supra* note 3, at 1914.

that conclusion and have cited numerous allegations of predatory and unfair lending practices filed against national banks and their affiliates.[112] The states have also acted vigorously and effectively in combating predatory lending abuses. For example, the states have played leading roles in investigating lending violations and obtaining settlements totaling nearly $850 million from Providian National Bank, First Alliance and Household International.[113] During 2003, state bank supervisory agencies performed more than 20,000 investigations in response to consumer complaints about abusive lending practices, and those investigations produced more than 4,000 enforcement actions.[114]

Similarly, state officials have been the leaders in combating fraud and other serious misconduct in the securities and mutual fund industries. New York Attorney General Eliot

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[112] *See, e.g.,* Testimony of Diana L. Taylor, N.Y. Superintendent of Banks, before the Subcomm. on Oversight and Investigations of the Financial Services Comm., U.S. House of Representatives, Jan. 28, 2004, at 13-18; Comments of the National Consumer Law Center *et al.,* filed in OCC Docket 03-16, *supra* note 3, Oct. 6, 2003, Part 2, *available at* www.nclc.org/initiatives [hereinafter "NCLC Comments"].

[113] *See* U.S. Gen. Acct'g Off., Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending, Jan. 2004, GAO-04-280, *available at* www.gao.gov, at 62-63, 106-07 (app. I) (describing state enforcement efforts); Paul Beckett, *First Alliance Agrees To Large Settlement on Predatory Loans,* Wall St. J., Mar. 22, 2002, at A6; Paul Beckett & Joseph T. Hallinan, *Household May Pay $500 Million Over 'Predatory' Loan Practices,* Wall St. J., Oct. 11, 2002, at A1; Nicholas Kulish, *Providian to Pay at Least $300 Million To Settle Allegations on Card Operations,* Wall St. J., June 29, 2000, at B12. A former senior executive in the credit card industry stated that "[a] California state prosecutor, acting like Eliot Spitzer opposite the SEC, embarrassed the OCC into taking action against Providian [National] Bank for telemarketing and pricing practices that bordered on the criminal. For a decade Providian had been well known in the [credit] card industry as the poster child of abusive consumer practices, but apparently not to the OCC." *Viewpoints: Comptroller Has Duty to Clean Up Card Pricing Mess*, Am. Banker, Nov. 21, 2003, at 17 (letter to the editor from Duncan A. MacDonald, former general counsel of Citigroup's European and North American credit card businesses).

[114] *See* Views and Estimates of the Comm. on Financial Services on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005, 108th Cong., 2d Sess. (Comm. Print, Feb. 25, 2004) [hereinafter "2004 House Fin. Serv. Comm. Budget Res."], at 16.

Spitzer spearheaded the investigation and joined with other state officials and the Securities and Exchange Commission ("SEC") in obtaining a landmark settlement with ten large Wall Street investment banking firms, including five firms affiliated with major banks. That agreement requires the ten firms (i) to adopt broad structural reforms to eliminate conflicts of interest that caused their research analysts to issue biased and misleading investment advice, and (ii) to pay $1.4 billion in disgorged profits, penalties and funding to ensure the availability of independent research to investors.[115] News reports confirmed that it was Attorney General Spitzer – not federal regulators – who sparked the investigations of conflicts of interest and other abuses involving research analysts and investment bankers at Wall Street firms.[116]

Attorney General Spitzer and Massachusetts Secretary of State William Galvin have also led the investigative and enforcement efforts to stop late trading, market timing and other abusive practices involving mutual funds.[117] Some of the alleged abuses have involved mutual funds

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[115] *See, e.g.,* Rachel McTague & Kip Betz, *Research Analysts: Federal State Securities Regulators, NYSE, NASD, Spitzer Finalize Wall Street Settlement*, 35 Sec. Reg. & L. Rep. (BNA) 730 (2003) (reporting on settlement agreement entered into by five independent investment banking firms, as well as firms affiliated with the following five major banks – Citigroup, Credit Suisse, J.P. Morgan Chase, UBS and U.S. Bancorp).

[116] *See, e.g.,* Charles Gasparino, *The Stock-Research Pact: How Settlement Train Kept on Track,* Wall St. J., Dec. 23, 2002, at C1 (stating that the settlement was "a victory for one regulator in particular, New York Attorney General Eliot Spitzer," who "spearheaded" the investigation); Gretchen Morgenson, *Accord Highlights Wall St. Failures*, N.Y. Times, Dec. 20, 2002, at C1 (stating that "regulators at the [SEC], the New York Stock Exchange and NASD, all charged with protecting investors, fell down on their jobs during the stock surge of the late 1990's," and "[i]t took Eliot Spitzer . . . to spotlight the issue").

[117] *See, e.g.,* Kip Betz & Rachel McTague, *Crime: Spitzer Brings Criminal Charges, SEC Sues Over Alleged Late Trading*, 35 Sec. Reg. & L. Rep. (BNA) 2108 (2003); Kip Betz & Martha Kessler, *Mutual Funds: N.Y. AG Launches Probe of Fund Industry; Hedge Fund Pays $40M to Resolve Claims*, 35 Sec. Reg. & L. Rep. (BNA) 1505 (2003); Martha Kessler, *Mutual Funds: Mass. Regulators Charge Prudential Over Late-Trading Issues,* 35 Sec. Reg. & L. Rep. (BNA) 2100 (2003).

affiliated with major national banks, including Bank of America, Bank One, Fleet, and Wachovia. In March 2004, Bank of America and Fleet agreed to pay $675 million to settle charges of late-trading and market-timing abuses occurring in mutual funds managed by affiliates of the two banks.[118] In addition, Mr. Spitzer filed criminal charges against three former executives of a special-purpose national bank that allegedly helped a hedge fund to make illegal trades in mutual funds. The OCC ordered that bank to liquidate, but only *after* the bank's misconduct was revealed by Mr. Spitzer's investigation.[119]

In the mutual fund scandals, as in the Wall Street research debacle, federal regulators failed to take timely or effective measures to protect consumers from serious abuses, while state officials performed a vital public service in investigating and exposing shocking misconduct.[120]

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[118] *See Mutual Funds: BOA, FleetBoston Agree on $675 Million To Resolve SEC, N.Y. Charges Over Abuses*, 36 Sec. Reg. & L. Rep. (BNA) 513 (2004) (reporting on settlements requiring Bank of America and Fleet to pay a total of $675 in disgorged profits, penalties and fee reductions).

[119] *See* Todd Davenport*, Security Trust, 3 Former Execs Accused of Fraud*, Am. Banker, Nov. 26, 2003, at 3 (reporting that "Mr. Spitzer's investigation of late trading and market timing implicated Security Trust and 'triggered an investigation by the [OCC and other federal] agencies'").

[120] *See, e.g.,* Paula Dwyer, *Breach of Trust*, Bus. Week, Dec. 15, 2003, at 98 (stating that Attorney General Spitzer's investigation of mutual funds "ignited one of the biggest financial scandals in U.S. history," while "[t]he SEC put too much trust in mutual funds to do the right thing"); Tom Lauricella et al., *Spitzer Gambit May Alter Fund-Fee Debate: Alliance Capital Offers Fee Cut As Part of Proposed Settlement,* Wall St. J., Dec. 11, 2003, at C1 (stating that "Mr. Spitzer's office alone triggered the [mutual fund] investigations in early September. The SEC has scrambled to catch up"); Mike Maremont & Deborah Solomon, *Missed Chances: Behind SEC's Failings: Caution, Tight Budget, '90s Exuberance,* Wall St. J., Dec. 24, 2003, at A1 (stating that (i) the SEC "fail[ed] to spot almost every major financial scandal in recent years" because it was "a timid, poorly managed bureaucracy at a time when the markets it polices and the frauds it seeks to prevent were increasingly complex," and (ii) "Mr. Spitzer's small team has shown that regulators can do a lot with limited resources, if they deploy them strategically"); *Editorials: Eliot Spitzer, Once Again*, Bus. Week, Sept. 15, 2003, at 120 (editorial stating "Hooray for the state AGs . . . . Why did [the SEC] leave it to a state AG to oversee the mutual-fund industry, just as did with Wall Street research? . . . Once again, it is the state AGs who are

In response to congressional criticism of the SEC's performance, SEC Chairman William Donaldson acknowledged that the SEC "cannot be everywhere . . . . We depend on state and local [law enforcement] authorities to uncover malfeasance that may fly under our radar."[121] Other SEC officials have agreed that state enforcement agencies play an essential role in complementing the SEC's efforts to protect consumers from fraudulent and unfair practices occurring in the financial markets.[122]

Thus, state enforcement programs have proven to be a highly effective and necessary supplement to federal efforts to protect consumers from misconduct by providers of financial services. State regulators and consumer advocates have argued that the OCC lacks the motivation and administrative resources to enforce consumer protection laws against national banks and their operating subsidiaries.[123] In a recent budget-related resolution, the House

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the heroes to individual investors").

[121] Rachel McTague, *Enforcement: Donaldson Reinforces Message: State Enforcement Welcome, With Caveats*, 35 Sec. Reg. & L. Rep. (BNA) 1559 (2003) (quoting Chairman Donaldson's comment at a congressional hearing).

[122] *See* Richard Hill, *Securities Regulation: Conn. Regulator Declares State Oversight of Industry Trumps Distant Federal Efforts*, 35 Sec. Reg. & L. Rep. (BNA) 2103, 2104 (2003) (quoting statement by Antonia Chion, a senior SEC official, that "states have a complementary role with the SEC in punishing wrongdoers and preventing future abuses . . . . [C]riminal actions brought at the state level combined with civil remedies levied by the [SEC] are an effective one-two punch"); Richard Hill, *Corporate Governance: Spitzer Decries CEOs in Ad Saying Their Language Casts Doubt on Awareness*, 36 Sec. Reg. & L. Rep. (BNA) 521, 522 (2004) (reporting that another senior SEC official, Mark Schonfeld, praised state regulators for their "creative enforcement methods," and also said that the SEC has "achieved remarkable success when we've worked together with the states").

[123] *See, e.g.,* N.Y. Att'y Gen. Eliot Spitzer, Whose Side Are They On? The Federal Government's Effort to Curtail State Enforcement of Predatory Lending and Other Consumer Protection Laws, Feb. 24, 2004 (Georgetown Univ. lecture) [hereinafter "2004 Spitzer Georgetown Lecture"], at 7-13; Testimony of Diana L. Taylor, *supra* note 112, at 12-19; NCLC Comments, *supra* note 112, at 12-14; Jathon Sapsford, *Critics Cry Foul Over New Rules on Bank Review,* Wall St. J., Jan. 8, 2004, at C1 (noting that "[c]ritics say the OCC has found little evidence of predatory lending among the [2,100] banks it regulates because it has only 1,800

Financial Services Committee also questioned whether the OCC has sufficient administrative resources to "investigate all consumer complaints for 2150 national banks … from a single customer assistance center."[124] The Committee expressed further concern that the OCC's assertion of exclusive authority over "consumer law enforcement activities that typically have been undertaken by the States … could weaken the OCC's ability to carry out its primary mission of ensuring the safety and soundness of the national bank system …."[125]

In fact, the OCC's record in protecting consumers has not been impressive. Since June 2000, the OCC has taken public enforcement actions against only seven national banks based on claims of abusive or predatory lending practices. All seven enforcement proceedings involved special-purpose credit card banks or community banks.[126] To date the OCC has not issued a single public enforcement order against any of the largest national banks or their subsidiaries for abusive or predatory lending, even though a number of private lawsuits and other allegations have been filed against them.[127] In one well-known case, the OCC refused to help hundreds of

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examiners, who are more focused on the quality of the banks' lending portfolios than [on] the policies for interacting with consumers"). Because large banking organizations have entered more risky lines of business and have adopted more complex organizational structures during the past decade, it has become increasingly difficult for federal regulators to assess the safety and soundness of such entities. *See* Wilmarth, *Transformation, supra* note 91, at 316-407, 454-75. Accordingly, there are strong reasons to doubt whether the OCC can afford to devote a significant portion of its limited supervisory resources to ensure that consumer protection laws are properly enforced against more than 2,100 national banks and a myriad of operating subsidiaries.

[124] House Fin. Serv. Comm. Budget Res., *supra* note 114, at 16.

[125] *Id.*

[126] *See* OCC Docket 04-04, *supra* note 3, 69 Fed. Reg. at 1913. The largest of the seven enforcement actions, against Providian National Bank, was taken in response to an investigation initiated by a California prosecutor. *See supra* note 113.

[127] *See* Testimony of Diana L. Taylor, *supra* note 112, at 13-18 (describing allegations of predatory or abusive lending practices filed against several leading national banks or their affiliates); NCLC Comments, *supra* note 112, pt. II.A. (listing more than twenty court cases filed

consumers who complained after Fleet raised the interest rates on their credit cards despite promises of a "fixed" rate.[128] When an aggrieved customer filed a federal class action in December 2000, alleging deceptive lending practices by Fleet, the OCC responded by submitting amicus briefs *on behalf of Fleet* in both the district court and the Third Circuit Court of Appeals.[129] The Third Circuit, however, determined that plaintiff had presented a genuine issue for trial based on her claim that Fleet's disclosures were misleading and violated the Truth in Lending Act ("TILA").[130] Based on the Third Circuit's opinion, one can certainly question whether the OCC acted properly when it concluded that federal law did not give customers any reasonable grounds for proceeding against Fleet.[131]

Two other cases indicate that state officials are far more likely than the OCC to take

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against major national banks or their affiliates, alleging "illegal or predatory lending activities").

[128] *See* Bravin & Beckett, *supra* note 97 (quoting a representative letter, in which the OCC declined to help a complaining customer of Fleet and said, "we can only suggest that you contact private legal counsel regarding any additional remedies").

[129] *See Roberts v. Fleet Bank (R.I.), N.A.*, 2001 WL 1486226, at *2 (E.D. Pa., Nov. 20, 2001 (referring to "the amicus brief filed by the [OCC]"), *aff'd in part, rev'd in part,* 342 F.3d 260, 262 (3d Cir. 2003) (noting the appearance of counsel for the OCC as amicus curiae).

[130] Fleet's credit card solicitation materials quoted a fixed annual percentage rate ("APR") and assured prospective customers that this "fixed APR" was "NOT an introductory rate" and "won't go up in just a few short months." *Roberts,* 342 F.3d at 263. Fleet's solicitation materials also represented that the fixed APR would change only if the customer failed to make required payments or closed her account. About a year after the plaintiff in *Roberts* received her credit card, Fleet notified her that it was raising its APR by 2.5% in reliance on a general provision of Fleet's cardholder agreement. That provision, which allowed Fleet to change the terms of the cardholder agreement at any time, had not been included or quoted in Fleet's solicitation materials. *Id.* at 264. The Third Circuit concluded that "[c]onstruing the TILA strictly against the creditor and liberally in favor of the consumer, as we must, we believe that the TILA disclosures [made by Fleet] in this case, read in conjunction with the solicitation materials, present a material issue of fact as to whether Fleet clearly and conspicuously disclosed its right to change the APR." *Id.* at 266.

[131] *See* Bravin & Beckett, *supra* note 97 (describing a representative letter sent by the OCC to a Fleet customer).

strong and effective enforcement measures against major national banks. In June 1999, Minnesota Attorney General Mike Hatch sued U.S. Bancorp for selling confidential customer information to telemarketers in violation of the federal Fair Credit Reporting Act and three Minnesota statutes that prohibited consumer fraud, false advertising and deceptive trade practices.[132] U.S. Bancorp settled the case by paying a $3 million fine and agreeing to implement new policies designed to safeguard its customers' privacy.[133] U.S. Bancorp's "egregious" and widely-condemned sales of customer data helped spur Congress to adopt the privacy provisions contained in Title V of GLBA.[134] However, even though Comptroller Hawke had criticized banks for selling customer information to telemarketers under circumstances that were "seamy, if not downright unfair and deceptive,"[135] the OCC never took any public enforcement action against U.S. Bancorp.

In December 2000, Attorney General Hatch sued Fleet's mortgage operating subsidiary

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[132] Peter P. Swire, *The Surprising Virtues of the New Financial Privacy Law*, 86 MINN. L. REV. 1263, 1288 (2002); Scott Barancik & Dean Anason, *U.S. Bancorp Charged with Selling Data On Customers*, AM. BANKER, June 10, 1999, at 1.

[133] Lavonne Kuykendall, *After Privacy Policy Makeover, U.S. Bancorp Covets Recognition*, AM. BANKER, Aug. 14, 2001, at 1 [hereinafter Kuykendall, *Privacy Makeover*]; Lavonne Kuykendall, *Managing Privacy: Fined, U.S. Bancorp Learns About the Fine Line*, AM. BANKER, Aug. 8, 2001, at 1.

[134] 15 U.S.C. §§ 6801-27; Swire, *supra* note 132, at 1265-73 (describing the privacy provisions included in Title V of GLBA); id. at 1288-89 (describing U.S. Bancorp's conduct as "particularly egregious," and discussing the impact on Congress of the charges against U.S. Bancorp); *see also* Barancik & Anason, *supra* note 132 (reporting that Minnesota's suit against U.S. Bancorp "fed a growing firestorm over consumer privacy" and "lawmakers were demanding a legislative crackdown").

[135] Swire, *supra* note 132, at 1288 (quoting speech given by Comptroller Hawke to the Consumer Bankers Association on June 7, 1999, two days before Attorney General Hatch filed suit against U.S. Bancorp).

for privacy violations arising out of a similar telemarketing scheme, in which Fleet's subsidiary sold confidential customer data and provided other assistance to telemarketers who solicited the subsidiary's customers for "membership programs."[136] Attorney General Hatch charged Fleet's subsidiary with violations of the FTC's Telemarketing Sales Rule and the same three Minnesota statutes cited in the U.S. Bancorp case.[137] Once again, the OCC did not take any enforcement action against Fleet. Instead, as it did in the Fleet credit card case, the OCC filed an amicus brief that *supported* Fleet's unsuccessful attempt to dismiss the lawsuit.[138] In contrast to the OCC, the FTC filed an amicus brief *on behalf of Minnesota*.[139]

Since 1999, the OCC has brought only two public enforcement actions alleging violations of customer privacy rules—one against a California community bank and the other against two former employees of a Colorado community bank.[140] Thus, as in the case of predatory lending,

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[136] *Minnesota v. Fleet Mortgage Corp.,* 158 F. Supp. 2d 962 (D. Minn. 2001).

[137] *Id.* at 964-65 (describing the factual allegations and legal claims made by Attorney General Hatch against Fleet Mortgage); Kuykendall, *Privacy Makeover*, *supra* note 133 (same); *see supra* notes 73-77 and accompanying text (discussing *Minnesota v. Fleet Mortgage Corp.*, 181 F. Supp. 2d 995 (D. Minn. 2001)).

[138] *Fleet Mortgage*, 181 F. Supp. 2d at 999-1000 (describing the OCC's arguments, as amicus curiae, *supporting* Fleet Mortgage Corp.'s motion to dismiss).

[139] *See id.* at 996 (referring to the appearance of counsel for the FTC and the OCC as amici curiae).

[140] *See* Paul Beckett, *'Payday' Loans Are Dealt Blow By Regulators: ACE Cash and California Bank Face Fines as U.S. Comptroller Seeks to Curb Lending Practice*, WALL ST. J., Oct. 30, 2002, at C1 (describing an administrative order issued by the OCC against Goleta National Bank, and explaining that the order was partly based on the "failure [of Goleta's agent] to safeguard customer files on loans issued by Goleta", as that failure "could have compromised the customers' right to privacy"); Todd Davenport, *E-Mail Leads to a Ban*, AM. BANKER, April 8, 2003, at 1 (reporting that the OCC had "barred from the [banking] industry" two former employees of Grand Valley National Bank, because they "violated privacy regulations by e-mailing confidential [customer] loan files to an unauthorized third party.").

the OCC's enforcement of consumer privacy laws has followed a pattern of public jawboning, a handful of public prosecutions against smaller national banks, and the absence of any public proceeding against a major national bank. It would be reassuring to infer from this pattern that *only small national banks* have been guilty of predatory lending practices or privacy infractions. That inference clearly seems unwarranted, however, given the number of lending abuses and privacy violations asserted against leading national banks by consumers and state officials.

Based on a search of the OCC's database for publicly available enforcement orders issued during the past decade, I was unable to find a single instance in which the OCC issued an enforcement order against one of the nine largest national banks for violating a consumer protection law.[141] Unfortunately, the OCC's self-interest provides a plausible explanation for the agency's failure to bring a public enforcement proceeding against any major national bank for consumer protection violations. As discussed above, the OCC's prestige and budgetary resources depend on its ability to attract and retain the allegiance of large multistate banks.[142] As a consequence, the OCC's bureaucratic incentives create a clear risk of regulatory capture

[141] As of September 30, 2003, the nine largest bank holding companies whose lead bank subsidiaries operated under national charters were Citigroup (parent company of Citibank), Bank of America, Wells Fargo, Wachovia, Bank One, FleetBoston (parent company of Fleet Bank), U.S. Bancorp (parent company of U.S. Bank), SunTrust and National City. *See Industry Snapshot: Bank and Thrift Companies with the Most Assets; On Sept. 30, 2003,* AM. BANKER, Jan. 30, 2004, at 6. I ran the names of each of the nine banks through the "Enforcement Actions Search" database on the OCC's website, *available at* www.occ.treas.gov/enforce/enf_search.htm. I then reviewed the descriptions of all enforcement orders in which any of the nine banks was named as an interested party since December 31, 1993. Most of the orders were removal orders or industry-wide prohibitions imposed against individual bank employees for violations of law. *See* 12 U.S.C. §§ 1818(g), 1829 (2000).

[142] *See supra* notes 98-99 and accompanying text; 2004 Spitzer Georgetown Lecture, *supra* note 123, at 7.

whenever the OCC considers the possibility of taking vigorous enforcement action against one of its most important regulated constituents. Given these circumstances, the OCC should not be allowed to prevent state authorities from carrying out their traditional responsibility for protecting consumers against abusive practices committed by national banks or their operating subsidiaries.

Conclusion

The OCC's preemption and visitorial powers rules are clearly designed to advance the OCC's self-interest by persuading large banks with interstate branches to operate under national charters. Unless overturned, the OCC's rules will probably destroy the competitive balance that Congress has long maintained within the dual banking system. Within the relatively near future, the banking industry is likely to resemble today's thrift industry, with large, multistate institutions holding federal charters and the state system being reduced to a dwindling number of small, community-based institutions. Assuming that outcome, the dual banking system will cease to function in any real sense. There will no longer be a meaningful chartering option for banks, and banks will lose their current "escape valve" from outmoded or arbitrary regulation. As a consequence, the competitive dynamic between federal banking agencies and state bank commissioners, which has produced a remarkable record of regulatory innovation and flexibility over the past century, will lose all or most of its force.

The states' loss of authority over large banks and their operating subsidiaries will have other highly adverse consequences. The ability of states to regulate the most important providers of financial services will be greatly impaired, and there will be a corresponding loss of protection for consumers victimized by illegal, deceptive and unfair financial practices. In addition, the traditional primacy of the states in the field of corporate governance will be undermined, because states will no longer be able to regulate an important category of state-chartered business corporations.

Of course, Congress could choose in its wisdom to adopt legislation mandating these drastic changes in our systems of banking regulation and corporate governance. However, Congress has never done so. In 1994, Congress made clear in the Riegle-Neal Act that it remained firmly committed to the fundamental principles of the dual banking system, including the general application of state laws to both state *and* national banks. Absent a fresh mandate from Congress, the OCC's new rules are clearly unlawful and must be rescinded.

Thank you for your consideration of this prepared statement, and I would be pleased to answer your questions.

Arthur E. Wilmarth, Jr. (4/7/04)

Attachment (Appendix A – Outline of Key Supreme Court Cases on Preemption)

APPENDIX A TO TESTIMONY OF ARTHUR E. WILMARTH, JR. (4/7/04)

Key Supreme Court Cases Describing Preemption Standards for National Banks

In January 2004, the Office of the Comptroller of the Currency ("OCC") adopted new rules to determine the application of state laws to national banks. Under the OCC's new rules, state laws will be preempted if they "obstruct, impair, or condition a national bank's ability to fully exercise its powers to conduct activities authorized under Federal law." State laws will apply to national banks *only* to the extent that they "incidentally affect the exercise of national bank powers." 69 Fed. Reg. 1904, 1916-17 (2004) (text of amended 12 C.F.R. §§ 7.4007 - 7.4009 & 34.4). According to the OCC, "incidental" state laws are those that "do not regulate the manner or content of the business of banking authorized for national banks, but rather establish the legal infrastructure that makes practicable the conduct of that business." Id. at 1913. In other words, only *helpful* state laws that make it "practicable" for national banks to do business will apply under the OCC's new rules. State laws that place any "condition" on the business activities of national banks will be preempted.

The OCC's new rules create a regulatory scheme of de facto field preemption for national banks. The OCC made this point clear by issuing a checklist showing that the scope of preemption created by its new rules is substantively identical to the preemptive breadth of similar regulations adopted by the Office of Thrift Supervision ("OTS"). The OTS has proclaimed that its regulations "occup[y] the field" with respect to lending, deposit-taking and other "operations" of federal savings associations. *See* 12 C.F.R. §§ 545.2, 557.11 & 560.2.

As shown below, the OCC's new rules are incompatible with authoritative decisions of the Supreme Court. The Court's decisions have made clear that the National Bank Act and related federal statutes do *not* create a regime of field preemption for national banks or permit the OCC to do so. Instead, the Court has affirmed that state laws *do* apply to national banks *except* in situations where a state law creates an "irreconcilable conflict" with a federal statute. *Barnett Bank of Marion County, N.A. v. Nelson,* 517 U.S. 25, 31 (1996).

1. *Atherton v. FDIC,* 519 U.S. 213 (1997):

> "[I]n 1870 and thereafter this Court held that federally chartered banks are subject to state law." Id. at 222. Immediately after this statement, which affirmed the general application of state laws to national banks, the Court discussed its earlier opinion in *National Bank v. Commonwealth,* 76 U.S. (9 Wall.) 353, 362 (1870), as follows:
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> > "In *National Bank* the Court distinguished *McCulloch* [*v. Maryland,* 17 U.S. (4 Wheat.) 316 (1819)] by recalling that Maryland's taxes were "used . . . to destroy," and it added that federal banks
> >
> > > 'are subject to the laws of the State, and are governed in their daily course

> of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.' 9 Wall., at 362." 519 U.S. at 222-23.

Thus, in both *Atherton* and *Commonwealth*, the Court made clear that (1) "federally-chartered banks are subject to state law," and (2) the decision in *McCulloch v. Maryland* struck down Maryland's tax because that tax would be "used . . . to destroy" the Second Bank of the United States. In addition, *Commonwealth* explained that a state law would be preempted only when it "incapacitates [national] banks from discharging their duties to the [federal] government."

The OCC has quoted another passage from *Commonwealth,* where the Court said that "the agencies of the Federal government are only exempted from State legislation, so far as that legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve that government." At the time of *Commonwealth* (1870), national banks were the principal purchasers of U.S. government bonds and also issued circulating notes backed by those bonds. The sponsors of the National Bank Act of 1864 intended that the newly-created national banks would help the federal government's funding operations for the Civil War and would also provide the nation with a more stable supply of currency. Thus, *Commonwealth* obviously referred to the national banks' role as "agencies of the Federal government" in the public funding and currency areas, and the Court forbade the application of any state law that would "impair their efficiency" in carrying out their PUBLIC functions. This passage in *Commonwealth* did NOT exempt the PRIVATE business activities of national banks (e.g., making loans, negotiating bills of exchange and accepting deposits) from the application of state laws.

National banks lost their role as leading purchasers of government bonds and as primary issuers of the nation's currency when the Federal Reserve Act of 1913 ("FRA") was enacted. Since 1913, Federal Reserve notes have functioned as the primary U.S. currency in place of the superseded national bank notes. For discussions of the important differences in the activities of national banks before and after the FRA, see, e.g., Milton Friedman & Anna J. Schwartz, A Monetary History of the United States, 1867-1960, at 16-23, 189-96 (1963); Herman E. Kroos & Martin R. Blyn, A History of Financial Intermediaries 44-45, 52-54, 96-100, 118-21 (1971). Thus, language in *Commonwealth* and other Supreme Court cases decided *before* 1913, which discusses the need to protect the "efficiency" of national banks in carrying out their PUBLIC "duties" to the national government, is NOT fairly applicable to current state laws that regulate the PRIVATE business activities of today's national banks.

The OCC has cited other Supreme Court decisions issued before 1913, which include comparable language and obviously reflect the public funding and currency-related operations of national banks. Those cases include *Easton v. Iowa,* 188 U.S. 220 (1903); *Davis v. Elmira Savings, Bank,* 161 U.S. 275 (1896); *Farmers' & Mechanics National Bank v. Dearing,* 91 U.S. 29 (1875); and *Tiffany v. National Bank of Missouri,* 85 U.S. 409 (1874). In *Tiffany,* the Court said that "National banks have been National favorites" because "[t]hey were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government." In *Dearing,* the Court observed that national banks were "instruments designed to be used to aid the [federal] government in the administration of an important branch of the public service." 91 U.S. at 33. In *Davis,* the Supreme Court said that a state law is preempted when it "impairs the efficiencies of these agencies of the Federal government to discharge the duties, for the performance of which they were created." 161 U.S. at 283. In *Easton,* the Court quoted the very important distinction made by Chief Justice John Marshall between (i) the general application of state laws to a "private corporation" that carries on the "mere business of banking," and (ii) the immunity from state laws enjoyed by a "public corporation" that is "an instrument which is 'necessary and proper for carrying into effect the powers vested in the [federal] government.'" 188 U.S. at 229-30 (quoting *Osborn v. Bank of the United States,* 22 U.S. (9 Wheat.) 738, 860-63 (1824)).

In *Osborn,* Chief Justice Marshall declared that the Second Bank of the United States "would certainly have been subject to the taxing power of the State, as any individual would be," if the Second Bank was a "mere private corporation, engaged in its own business," and "having private trade and private profit for its great end and principal object." 22 U.S. (9 Wheat.) at 859. In keeping with Marshall's dictum, Congress amended 12 U.S.C. § 548 in 1969, to ensure that state banks and national banks receive equal treatment under state tax laws. The Senate committee report explained the need for this amendment in the following terms:

> There may have at one time been justification for giving national banks privileges and immunities which were denied State banks, under the theory that national banks are peculiarly an instrumentality of the Federal government, and, as such, hold a unique and distinct position from that of other institutions. Without specifically addressing the question of whether national banks remain, in substance, such a Federal instrumentality, *the committee is agreed that there is no longer any justification for Congress continuing to grant national banks immunities from State taxation which are not afforded State banks.*

S. Rep. No. 91-530, at 2 (1969), reprinted in 1969 U.S. Code Cong. & Ad. News 1594, 1595 (emphasis added).

Thus, the Supreme Court might well have used a more tolerant preemption standard in cases decided prior to 1913 if the national banks involved in those early cases had NOT been engaged in important "public" functions as "agencies" of the federal government. In addition, several early cases agreed with *Commonwealth* that state laws *did* apply generally to national banks in the absence of an irreconcilable conflict with federal law. *See, e.g., Davis,* 161 U.S. at 287 (affirming that "so far as not repugnant to acts of Congress, the contracts and dealings of national banks are left subject to the state law"); *Waite v. Dowley,* 94 U.S. 527, 533 (1877) (holding that "national banks . . . are subject to State legislation, except where such legislation is in conflict with some act of Congress, or where it tends to impair or destroy the utility of such banks, as agents or instrumentalities of the United States, or interferes with the purposes of their creation"); *McClellan v. Chipman,* 164 U.S. 347 (1896) (discussed in Part 4, below).

2. *Barnett Bank of Marion County, N.A. v. Nelson,* 517 U.S. 25 (1996):

> "In defining the pre-emptive scope of statutes and regulations granting a power to national banks, [the Supreme Court's] cases take the view that normally Congress would not want States to 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." Id. at 33.

Thus, the preemption standard established by *Barnett Bank* affirms that state laws *do* apply to national banks *unless* a particular state law would "prevent or significantly interfere with the national bank's exercise of its powers." In 15 U.S.C. § 6701(d)(2)(A), adopted as part of Section 104 of the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1353 ("GLBA"), Congress specifically endorsed the "prevent or significantly interfere with" formulation as the governing preemption standard under *Barnett Bank.* Section 6701(d)(2)(A) declares that "[i]n accordance with the legal standards for preemption set forth in the decision of the Supreme Court of the United States in Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25 (1996), no State may . . . prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage, directly or indirectly, . . . in any insurance sales, solicitation, or crossmarketing activity." The conference report on GLBA confirmed that the "prevent or significantly interfere with" standard for preemption, as used in Section 6701(d)(2)(A), is the rule "set forth in *Barnett Bank*." H.R. Rep. No. 106-34, at 156-57 (1999) (Conf. Rep.), reprinted in 1999 U.S. Code Cong. & Ad. News 245, 251. Congress did NOT indicate that any OTHER standard would be appropriate for determining preemption issues under *Barnett Bank*.

The OCC has cited *Barnett Bank* for the proposition that a state may not place any "condition" on the exercise of a national bank's powers. The relevant passage of *Barnett Bank* explains that "where Congress has not conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies." 517 U.S. at 34. This passage of *Barnett Bank* makes clear that a state may not try to *prevent or significantly interfere with* the use of a federal power by requiring national banks to obtain the state's permission as a "condition" for exercising that power. In other words, a state may not impose a "condition" that amounts to a state veto over the use of a federal power. See 517 U.S. at 31-32 (rejecting Florida's argument that "the Federal Statute removes only federal legal obstacles, not state legal obstacles, to the sale of insurance by national banks"). *Barnett Bank* did NOT say that a state may never *affect* the exercise of a federal power by requiring national banks, in the course of using the power, to satisfy reasonable "conditions" that all similarly-situated persons must meet.

3. *Anderson National Bank v. Luckett,* 321 U.S. 233 (1944):

> "This Court has often pointed out that national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions." Id. at 248.

The first part of the *Luckett* rule clearly supports the Court's statement in *Atherton* that "federally chartered banks are subject to state law." 519 U.S. at 222. The second part of the *Luckett* rule, adopting an "undue burden" test, is consistent with the "prevent or significantly interfere with" standard set forth in *Barnett Bank,* 517 U.S. at 33.

In *Luckett*, the Court upheld the validity of a Kentucky law that required all banks (including national banks) to transfer dormant deposit accounts to the state, so that state officials could commence legal proceedings to determine whether the dormant accounts had been abandoned and should be escheated to the state. In the following passage, the Court affirmed that state laws generally apply to the deposit relationships created by national banks:

> "[T]he mere fact that the depositor's account is in a national bank does not render it immune to attachment by the creditors of the depositor, as authorized by state law. . . .
>
> [A] bank account is . . . a part of the mass of property within the state whose transfer and devolution is subject to state control. . . . It has never been suggested that non-discriminatory laws of this type are so burdensome as to be inapplicable to the accounts of depositors in national banks.
>
> . . . [A]n inseparable incident of a national bank's privilege of receiving deposits is its obligation to pay them to the persons entitled to demand payment according to the law of the state where it does business. A demand for payment of an account by one entitled to make the demand does not infringe or interfere with any authorized function of the bank." Id. at 248-49.

Other post-1913 decisions of the Supreme Court that have upheld the general application of state laws to national banks include:

Lewis v. Fidelity & Deposit Co., 292 U.S. 559, 564-66 (1934) (holding that (i) Congress has followed a "policy of equalization" based on the incorporation of state-law standards in a number of federal statutes governing national banks; and (ii) "a national bank is subject to state law unless that law interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with some paramount federal law").

First National Bank in St. Louis v. Missouri, 263 U.S. 640, 656 (1924) (declaring that "national banks are subject to the laws of a State in respect of their affairs unless such

> laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States").

The OCC has frequently cited *Franklin National Bank v. New York,* 347 U.S. 373 (1954). In *Franklin* the Court held that a New York law was preempted because it prohibited national banks from advertising for savings deposits, thereby significantly interfering with their statutory power to accept such deposits. However, in *Franklin* the Court also observed that "national banks may be subject to some state laws in the normal course of business if there is no conflict with federal law." Id. at 378 n.7.

4. *McClellan v. Chipman,* 164 U.S. 347 (1896):

The Court explained that the preemption standards applicable to national banks

> ". . . contain a rule and an exception, the rule being the operation of general state laws upon the dealings and contracts of national banks, the exception being the cessation of the operation of such laws whenever they expressly conflict with the laws of the United States or frustrate the purpose for which national banks were created, or impair their efficiency to discharge the duties imposed upon them by the law of the United States." Id. at 357.

Thus, *McClellan* makes clear that the application of state laws to national banks is "the rule," while the preemption of state laws is "the exception." As a pre-1913 case, *McClellan* also uses the "impair their efficiency" standard ONLY with respect to "the duties imposed upon [national banks] by the law of the United States" – namely, their duties to purchase U.S. bonds and to issue circulating notes backed by those bonds.

McClellan upheld the validity of a Massachusetts law that prohibited all creditors (including banks) from accepting preferential transfers of property from insolvent debtors. The plaintiff national bank argued that the state law interfered with the bank's ability to exercise its statutory power (under the predecessor of 12 U.S.C. § 29) to accept real estate as security for the payment of pre-existing debts. The Supreme Court rejected this argument in the following terms:

> "No function of [national] banks is destroyed or hampered by allowing the banks to exercise the power to take real estate, *provided only they do so under the same conditions and restrictions to which all the other citizens of the State are subjected,* one of which limitations arises from the provisions of the state law which in cases of insolvency seeks to forbid preferences between creditors." Id. at 358 (emphasis added).

Hence, *McClellan* clearly upholds the authority of states to place reasonable, nondiscriminatory "conditions" and "restrictions" on the activities of national banks, as long as the state provisions do not create an irreconcilable conflict with federal statutes.

5. Congressional Interpretation of Preemption Cases

The conference report on the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 ("Riegle-Neal Act"), endorsed the longstanding congressional policy of "maintaining the balance of Federal and State law under the dual banking system," and explained that the general application of state laws to national banks was an essential element of that policy:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, *regardless of the type of charter an institution holds.* In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities. Federal banking agencies, through their opinion letters and interpretive rules on preemption issues, play an important role in maintaining the balance of Federal and State law under the dual banking system. Congress does not intend that the [Riegle-Neal Act] alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities.
>
> Under well-established judicial principles, *national banks are subject to State law in many significant respects. . . . Courts generally use a rule of construction that avoids finding a conflict between Federal and State law where possible.* The [Riegle-Neal Act] does not change these judicially established principles.

H.R. Rep. No. 103-651 (Conf. Rep.), at 53 (1994) (emphasis added), reprinted in 1994 U.S. Code Cong. & Ad. News at 2068, 2074.

Thus, the conference report on the Riegle-Neal Act expressly approved earlier judicial decisions upholding the general application of state laws to national banks, such as *Commonwealth, McClellan* and *Luckett.* The conference report also established the clear intent of Congress that the advent of nationwide banking should *not* change existing "judicially established principles" requiring national banks to comply with state laws. Accordingly, the conference report decisively refutes the OCC's frequently-stated claim that the development of large, multistate banks demands a more sweeping preemption of state laws in order to advance the interests of the "national banking system."

Arthur E. Wilmarth, Jr. (4/7/04)