REVIEW OF THE NATIONAL BANK PREEMPTION RULES

S. HRG. 108–864

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HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

THE OFFICE OF THE COMPTROLLER OF THE CURRENCY RULEMAKINGS PERTAINING TO THE APPLICABILITY OF STATE LAWS TO NATIONAL BANKS

APRIL 7, 2004

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Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

24–076 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
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C O N T E N T S

WEDNESDAY, APRIL 7, 2004

WITNESSES

Additional Material Supplied for the Record

REVIEW OF THE NATIONAL BANK PREEMPTION RULES

WEDNESDAY, APRIL 7, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 2:05 p.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order. I would like to thank everyone for being here today.

The purpose of this hearing is to examine the Office of the Comptroller of the Currency, OCC's, recently issued rules on preemption and visitorial powers. While these may be very technical provisions, I believe they merit our close consideration because of the significant consequences for our dual banking system.

In order to get a full appreciation of these issues I think it is important to ask some basic questions about the rules such as, why are they necessary? Was the OCC acting within its legal authority when it issued them? What new powers or responsibility do they provide to the OCC? What powers or responsibilities do they take away from the States? What impact, if any, will the new rules have on the development and enforcement of consumer protection standards? Finally, in the absence of such rules, what, if any, negative consequences would there have been for national banks and their customers?

I look forward to hearing from the panelists on these and other questions that will come from the Committee.

Additionally, I also look forward to examining some of the larger issues implicated by these rules. For example, what is the appropriate role of State governments in the regulation of financial services within a national economy? Do these rules in any way affect such roles? Do these rules create negative consequences for the operation of the dual banking system?

In the end, I believe that it is extremely important for the Committee to examine all these questions so that we can have a full appreciation of all the implications of these new rules.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. I am going to take a moment or two here, with the Chairman's indulgence.

Chairman SHELBY. Proceed as you wish.

Senator SARBANES. I am very pleased to welcome this panel of witnesses before the Committee this afternoon to testify on the recently adopted OCC rules on national bank preemption and visitorial powers. Mr. Chairman, I want to thank you for holding this hearing.

Chairman SHELBY. Absolutely.

Senator SARBANES. The actions by the OCC have significant and far-ranging consequences and deserve close examination by the Congress.

Let me state at the outset that I am opposed to the actions of the OCC. Last November, I joined in a letter with my Democratic colleagues on this Committee in which we urged the OCC to defer any further rulemaking on the preemption of State laws at that time and, instead, to examine vigorously claims of predatory lending and other violations of State consumer protection laws by national banks and their operating subsidiaries. In that letter we stated,

> Congress has previously voiced its intent that national banks not be immune from coverage by State laws. The House-Senate Conference Committee report on the 1994 Riegle-Neal Interstate Branching and Bank Efficiency Act stated that, "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." In enacting the Gramm-Leach-Bliley Act in 1999, Congress affirmed the Supreme Court standard in Barnett Bank that State laws apply to national banks unless those laws serve to prohibit or significantly interfere with the national banks' Congressionally authorized powers.

Regrettably, the OCC chose to finalize its proposed regulations in January. As a general matter, my inclination is to defer to bank regulators in the exercise of their authority, especially if it relates to safety and soundness. They are charged with making an independent judgment, presumably with the public interest foremost in mind. And I understand that those judgments may not always please everyone.

However, the OCC's actions in this instance led me to depart from this general approach. First, the OCC's actions do not relate directly to the safety and soundness of the financial system. They instead go to the relationship between Federal and State-chartered banks and thrifts, and the historic balance of responsibilities they share. Second, the OCC's actions have led to such a unanimous and strong outcry from State officials as to suggest that fundamental damage has been done to the Federal-State relationship. The National Association of Attorneys General, the Conference of State Bank Supervisors, the National Governors Association, the National Conference of State Legislatures have all strongly opposed the OCC's action. Third, the OCC's actions have been opposed by consumer, civil rights, and community groups from across the country as an assault on consumer protection as applied to nationally chartered banks and their State-chartered operating subsidiaries.

The intensity of opposition from the State officials and consumers, civil rights, and community groups has been exceptionally strong.

The attorneys general of all 50 States submitted a comment letter to the OCC on October 6 expressing their opposition to the preemption and visitorial powers rules and urging the OCC to defer further action on them. I want to quote from that letter because it summarizes the concerns raised about the actions of the OCC.

> The OCC's current proposal, coupled with the other recent OCC pronouncements on preemption, represent a radical restructuring of Federal-State relationships in the area of banking. In recent years, the OCC has embarked on an aggressive campaign to declare that State laws and enforcement efforts are preempted if they have any impact on a national bank's activities. The OCC has jealously pushed its preemption agenda into areas where the States have exercised enforcement and regulatory authority without controversy for years.
>
> The OCC's preemption analysis is one-sided and self-serving. The OCC has paid little deference to well-established history and precedent that has allowed the States and the OCC to co-exist in a dual regulatory role for over 130 years. That precedent has upheld this Nation's policy that national banks are subject to State laws unless the State laws significantly impair the national banks' powers created under Federal law. The OCC is destroying that careful balance by finding "significant interference" or "undue burden" whenever State law has any effect on a national bank.
>
> In the area of predatory mortgage lending, the OCC's actions are particularly disappointing. Instead of commending the States' efforts, the OCC has gone to great lengths to attack them and to declare that they are inapplicable to national banks and their operating subsidiaries. In their place, the OCC has recommended minimal protections that fail to address many of the worst predatory lending abuses.

Also on October 6, a coalition of 19 consumer, civil rights, and community groups, including the Consumer Federation of America and the Leadership Conference on Civil Rights, sent a comment letter to the OCC in which they stated, in part, and I quote:

> In 1994, Congress passed the Homeownership and Equity Protection Action to protect borrowers of high-cost loans from predatory lending practices. Unfortunately, the scourge of predatory lending did not go away and, in fact, increased in tandem with the explosion of subprime lending. Recognizing this continuing problem, various States have developed increasingly effective approaches to eradicating predatory lending, without drying up access to reasonably priced subprime mortgage credit. This is federalism as its best.
>
> Your proposal to preempt the State antipredatory lending laws is, at best, misguided, and at worst, a blatant attempt to increase the power of the OCC at the expense of homeowners, the sovereignty of the States, and the intent of Congress. We believe this proposal to be fundamentally flawed both in its assessment of the impact of State antipredatory lending laws and as to the powers Congress entrusted to the OCC. We urge the OCC to scrap its proposed preemption of State predatory lending laws, while continuing to develop its own advisory guidance to ensure that national banks are not engaged in predatory lending.

And, finally, Dudley Gilbert, the Legal Counsel for the Oklahoma State Banking Department, wrote an article in the *American Banker* on February 20 entitled "OCC's Preemption Rule is About Keeping Market Share," which provides a perspective on the OCC's actions from the viewpoint of a State banking regulator. And in that article, he says,

> The OCC's preemption rule seems to be more about protecting its remaining multi-State megabanks or attracting new ones to the fold than about "clarifying" a 140-year-old law. The OCC standard for preemption has been built on a political platform for the promotion of its charter.

The point was echoed in a *Wall Street Journal* article on January 28, 2002 entitled "Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers." In that article, they stated,

> The OCC solicitousness toward the businesses it oversees stems in part from its need to compete for their loyalty. In an uncommon arrangement, banks can choose

either a State or Federal regulator, and the selection has financial consequences. The OCC and State banking departments subsist entirely on fees paid by the institutions they regulate.

The Comptroller has asserted that State officials and consumer groups are all wrong, that the OCC is simply codifying existing judicial interpretation in its regulations, and that the OCC is actually enhancing consumer protection through its regulatory and enforcement actions. I must say I find that position very difficult to understand and accept. I think the criticisms that have been leveled by the State officials and the consumer groups seem to me to be right on point. And, of course, we will explore that matter in the course of this hearing.

Thank you very much, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Sarbanes.

Our first panel is composed of three people: John Hawke, Comptroller of the Currency; Roy Cooper, Attorney General, State of North Carolina; and Gavin Gee, Director of Finance, Idaho Department of Finance. I welcome all of you to the Committee. Your written testimony will be made part of the record in its entirety. We will start with Mr. Hawke.

STATEMENT OF JOHN D. HAWKE, JR.
COMPTROLLER OF THE CURRENCY
U.S. DEPARTMENT OF THE TREASURY

Comptroller HAWKE. Thank you, Mr. Chairman and Ranking Member Sarbanes. I appreciate the invitation to discuss the OCC's recently issued rules on preemption and visitorial powers. I want to start by emphasizing a few overarching considerations as background for the discussion of the rules themselves.

First, national banks and their subsidiaries are highly regulated and closely supervised. While we occasionally confront instances of abusive conduct at our banks, the overwhelming number of our banks operate in conformity with the law and with recognized standards of sound banking and fair practices. Because of this, it is not at all surprising that the State attorneys general virtually unanimously have repeatedly stated that predatory lending is not a problem in the regulated banking system.

Second, the OCC is committed to protecting and helping customers of national banks, and we have ample resources and formidable enforcement powers to carry out that commitment. We have a world-class consumer assistance group that resolves literally tens of thousands of inquiries and complaints every year. And where consistent or persistent problems have arisen, our track record shows that we will use our supervisory and enforcement powers promptly and effectively to fix them. With the formal enforcement powers that we have, plus the authority and influence that our examiners exercise over the banks they supervise, I believe we have an unmatched ability to afford consumers the protections that we all want for them.

Third, we recognize that our counterparts at other agencies and in State law enforcement share this commitment to protect consumers, and we welcome opportunities to share information and to cooperate and coordinate with them to address customer complaints and consumer protection issues. Through a coordinated and cooperative approach to the remedying of abuses, I believe we can achieve a high level of protection for consumers.

With that preamble, let me summarize what the OCC's new regulations do and what they do not do. While I recognize that there are some significant differences of opinion on many of the issues involved, I am concerned that there has been widespread misunderstanding and mischaracterization of what we have done.

The first regulation, which I will call the preemption rule, codifies principles that have been established in almost 200 years of decisions by the Supreme Court and lower Federal courts, that have been applied in innumerable interpretations and rulings of the OCC over many years, and that have been embodied in regulations of our sister agency, the Office of Thrift Supervision, for many years. The regulation provides clear and predictable guidance to national banks regarding the standards that apply to core banking activities: lending and deposit-taking.

The rule is based on the well-established principles that the States do not have the constitutional authority to limit or condition the exercise of powers that Congress has conferred on the instrumentalities that it creates, and that a State law cannot apply to a national bank if it obstructs, impairs, or conditions the bank's ability to exercise those powers unless Congress has provided that it should apply. The regulation then lists specific types of State laws that are preempted, substantially mirroring those already preempted by OTS.

It is important to emphasize what the regulation does not change, since some confusion may exist on this score. It does not establish brand-new standards or principles of preemption. It does not preempt State laws other than those listed. It does not immunize national banks from complying with a host of State laws that form the infrastructure of doing the business of banking, such as contract law, tort law, public safety laws, and generally applicable criminal laws. It does not preempt antidiscrimination laws. It does not extend to activities authorized for financial subsidiaries of national banks, which can exercise powers that are not permissible for the bank itself. It does not impinge on the functional regulation framework that Congress set in place in the Gramm-Leach-Bliley Act. It does not allow national banks to charge higher rates of interest than they previously could. It does not authorize any new national bank powers, such as real estate brokerage. And it makes no changes to existing OCC rules governing the activities of operating subsidiaries.

Our second rule, the visitorial powers rule, amends an existing regulation implementing a Federal statute that is as old as the national banking system itself and that grants the OCC exclusive authority to supervise, examine, and regulate the national banking system. Congress reemphasized this principle of exclusive visitorial powers only recently in the Riegle-Neal Interstate Branching law by explicitly providing that, to the extent State consumer protection laws apply to the interstate branches of national banks—that is, where those laws are not preempted under the longstanding principles I have referred to—the OCC is the exclusive enforcement authority for such laws with respect to national banks.

The visitorial powers statutes provide no exception for the States to regulate the banking activities of national banks through enforcement actions, and I believe it is well-recognized by State law enforcement officials that Federal law precludes them from taking administrative enforcement actions against a national bank with respect to its banking activities. What is at issue here is solely whether State officials can do through the courts what they cannot do directly, and our visitorial powers rule simply sets forth our understanding of the basic statute as precluding the exercise of similar visitation powers by resort to the courts.

The second, and equally important, issue that I want to address is the effects of these rule changes. In addition to clarifying which State laws apply and which do not apply to national banks, the rule also puts in place additional focused standards to protect customers of national banks from unfair, deceptive, abusive, or predatory lending practices. These new standards apply nationwide, to all national banks, and provide additional protections to national bank customers in every State, including those States that do not have their own predatory lending standards. The rule does not leave customers of national banks or their subsidiaries vulnerable to predatory lending practices. And I stress that the State Attorneys General have repeatedly said that the problems of predatory lending are not problems in the regulated banking system; they are problems that occur in the unregulated segment of the financial services industry.

The regulation first provides that national banks may not make consumer loans based predominantly on the foreclosure or liquidation value of a borrower's collateral. This will target the most egregious aspect of predatory lending, where a lender extends credit based not on a reasonable determination of a borrower's ability to repay, but on a lender's calculation of its ability to seize the borrower's accumulated equity in his or her home. And I should add that is a standard that is easy for bank examiners, and traditional for bank examiners, to examine for and to enforce.

The regulation also specifically provides that national banks shall not engage in unfair or deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act in their lending activities. The OCC was the first Federal banking agency to assert the power to take enforcement actions for violations of Section 5, a position that our sister agencies have recently adopted.

These rules supplement the very extensive guidance that we published last year admonishing our banks to stay well clear of predatory practices and telling them in no uncertain terms what we would do if we found such practices in any of our banks. I believe our rules and advisories on predatory lending go well beyond anything that any other bank regulatory authority has done in this regard. And I commend those advisories to the attention of anybody interested in this subject because they provide a very comprehensive definition of predatory lending and a very comprehensive mandate to our banks about how to steer clear of predatory lending.

Some may ask, why not allow State and local predatory lending laws to apply as well? Isn't more regulation better?

To that I would answer, not unless there has been a demonstration that more regulation is needed because the existing regulatory scheme does not work. That is not the case with respect to the national banking system. Again, whatever our differences with the State Attorneys General are, they have repeatedly stated that the problem of predatory lending is largely confined to unregulated, nondepository institutions and has not been in evidence in regulated banks or their subsidiaries. And, as I said, this is not at all surprising. National banks and their subsidiaries are highly regulated and closely supervised. The largest national banks have large teams of examiners on premises at all times.

Our approach to predatory lending is a comprehensive, ongoing, integrated supervisory approach focused on preventing predatory practices, not on banning or restricting specified loan products based on their terms. We have substantial resources available nationwide to make sure that our supervision, in this and other areas, is effective.

Additional regulation brings with it added costs which may lead to higher prices for consumers. It may also have undesirable collateral consequences. For example, there is a vigorous debate going on in the economic literature as to whether State predatory lending laws reduce the availability of nonpredatory subprime credit. I think there is widespread agreement, however, that these laws have reduced the volume of subprime lending, and it is far from the case that all subprime lending is predatory. Indeed, the expansion of the subprime market has played an extremely important role in our record level of homeownership and in making credit available to segments of the population, particularly minorities, who in the past have not had ready access to credit.

State and local laws that increase a bank's costs and its potential liabilities in connection with higher-risk subprime loans and that result in constrictions in the secondary markets, which we have seen, inevitably will cause some legitimate lenders to conclude that the costs and risks are not worth it. The result is diminished credit availability, and credit options available to a segment of potentially creditworthy subprime borrowers will be reduced.

Paradoxically, when such well-intentioned laws cause regulated banks to reduce their participation in the subprime market, they are deterring the most highly regulated segment of the industry, those subject to CRA requirements and those most likely to conform to accepted practices and standards. We believe our approach does not constrict credit availability from legitimate, highly regulated lenders and effectively protects customers of national banks and their subsidiaries against predatory lending practices.

Chairman SHELBY. Mr. Hawke, do you have much more?

Comptroller HAWKE. Just one paragraph, Mr. Chairman.

Chairman SHELBY. You are about finished?

Comptroller HAWKE. Yes.

In conclusion, we believe that our new rules are legally sound, that they enable national banks to operate in a manner fully consistent with the character of their Federal charter. Most importantly, coupled with the strong oversight and enforcement powers that the OCC can and will bring to bear, they do not leave national bank customers exposed to abusive practices. We share with our colleagues in the States a commitment to assuring that national banks' treatment of their customers meets the highest standards, and I am confident that if we work in cooperation and coordination, we can all fulfill that commitment.

Senator SARBANES. I am curious. Was the "in conclusion" in the statement, or was that a quick add-on?

[Laughter.]

Comptroller HAWKE. No, it is right here in the text.

Senator SARBANES. Okay.

Chairman SHELBY. Mr. Hawke, we did not want to rush you, but we have 2 or 3 minutes to vote, and Senator Corzine already has.

Comptroller HAWKE. The clock is not working here.

Chairman SHELBY. I was going to recognize him to make any opening statement, as long as he wanted to take, because we would like to hear everybody, Mr. Cooper and Mr. Gee, as soon as we get back. Can you do that?

Senator CORZINE. Sure, Mr. Chairman.

Chairman SHELBY. Okay. You are recognized.

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. [PRESIDING.] Thank you, Mr. Chairman.

This is the only time the guy on the far right-hand corner——

Senator SARBANES. It is all yours, Jon.

[Laughter.]

Senator CORZINE. Now you are seeing what poker is like, right?

Senator SARBANES. Don't get carried away.

[Laughter.]

Senator CORZINE. I think there might be about 25 years between me and thee. We will work on it.

Mr. Chairman, and to the witnesses, I want to thank all of you for being here, and I want to thank the Chairman for holding this hearing. This really is an important issue, this preemption of State consumer protection laws. A number of us feel quite strongly about it, and I want to thank Comptroller Hawke for both your testimony and, I think, a willingness to listen, if not necessarily agree on some of the directions we are taking here.

Let me start by saying I am deeply concerned about the OCC's action. The broad nature of this rule has profound implications for our dual banking system as well as the ongoing relationship between the Federal Government and the States. I certainly hear this on a regular basis with my people back in Trenton. Moreover, this rule has critical implications for consumer protections, which I think a number of people will speak to, and may well prove detrimental to that important effort.

Some have suggested that the OCC's actions stem from nothing more than a power grab. I am not sure I associated myself totally with that, but it certainly is something that is widely discussed in the press, the media, in general, and I would cite *The Wall Street Journal* friendly watchdog chart that I have included here, which I think is reflective of some of both the editorial comment and discussion that we see surrounding this topic.

While I do not accept that this is the sole purpose for the action, it does strike me curious that the only groups that have come out in support of the OCC action, as far as I can tell, are the very banks that are regulated.

Given these broad concerns, a decision of this magnitude in my view should only have been made after an exhaustive review and deliberations by Congress, this Committee, and both of the issues that I talked about have been raised with the OCC by Members of Congress from both sides of the aisle. In November, every Democratic Member of this Committee signed a letter to Comptroller Hawke that expressed concerns regarding the rationale, the pace, and implications of the OCC proposal. Included in that letter was the request that the agency defer final rulemaking until the implications of the rule on State enforcement of predatory lending laws could be better ascertained.

In the House, Sue Kelly, the Republican Chairwoman of the House's Financial Services Subcommittee on Oversight Investigations, and a bipartisan group of Members wrote the Agency in December also asking them to delay implementation of the rules until Congress could hold hearings to review the proposal and provide an appropriate signal of intent.

Unfortunately, those letters have not been attended to, and as I think all of you know, similar concerns have been expressed by the Nation's Governors, Attorneys General, State legislators, et cetera.

I think this needs to be reviewed, and the role of Congress in establishing the laws that govern our dual banking system and this Committee and its oversight need to be taken into account. And, you know, I think this is important in making sure that we maintain the confidence between the OCC and those of us who are responsible for oversight.

I hope that we can figure out a way to restore Congress' voice in this, and consideration, and I think there is a legitimate concern about the implications for the ability of our State legislatures and State governments to be involved in this dual banking system in a credible, strong way. I certainly think it is important for consumers. I am certainly going to be asking that we have a larger role in this, and I think it is important that this get an additional oversight look here among the Committee.

I guess I am about to transfer my sole moment in the sunlight here to Senator Allard, since he is a little closer to the middle and on the majority side. The Chairman asked me to chair until they return, but recognizing protocol, I will be a very generous fellow and hand that all back.

[Laughter.]

Then I will be able to ask Senator Allard whether I also could submit a letter from the New Jersey State Department of Banking and Insurance that challenges the conclusions reached by the National Home Equity and Mortgage Association concerning the impact of the New Jersey Homeownership Security Act is having on New Jersey's subprime market. I think there is a lot of reason for serious, objective study of the impact on these markets, and I think there is a good report along those lines.

Senator ALLARD. I have no objection and I hear no objection.

Senator CORZINE. Thank you, Mr. Chairman.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. [PRESIDING.] I will go ahead and give my statement for the record, and I see that we still have a vote going. We are waiting to complete testimony until the Chairman and the Ranking Member get back.

I would like to thank the Chairman for holding this hearing today to discuss two rules recently promulgated by the Office of the Comptroller of the Currency regarding preemption and visitorial powers of national banks. One of the rules clarifies the extent to which the operations of national banks are subject to State law; the other rule concerns the authority of the OCC to examine, supervise, and regulate national banks. I look forward to discussing the OCC's reasons for promulgating these rules as well as the potential implications of the two rules with respect to the country's economic system and particularly the Nation's housing markets.

The OCC has not only a difficult but also a very important duty to regulate lending and investment activity of national banks. With regulatory and supervisory authority over 2,200 national banks and 56 branches of foreign banks in the United States, the OCC plays an integral role in ensuring the safety and soundness of the national banking system, while ensuring fair and equal access to financial services for all Americans. With the broad-ranging authority granted to the OCC to approve or deny applications for new charters, approve or deny structural changes, issue cease-and-desist orders, and issue rules and regulations governing bank investment and lending, today's oversight hearing that will examine two recently published rules is certainly appropriate.

As Chairman of the Housing Subcommittee, I am concerned about how these new rules will impact the housing markets and predatory lending practices. I am hopeful that they will fulfill the OCC's mission of protecting consumers while contributing to an effective system of banking that has served our Nation so well.

Again, I would like to thank Comptroller Hawke and each of our witnesses for taking the time to testify before the Committee today, and I do look forward to your testimony.

What I am going to do, Senator Corzine, is go ahead and put us in recess until the Chairman and Ranking Member both get back. Then you and I can head down and vote. The second vote is apt to be a short vote. Instead of being a 15-minute vote, it will be a 10-minute vote. You and I can head on down. I expect the Chairman and the Ranking Member to be here shortly. So, I would suggest that if you want to stand and stretch as though you are in the seventh inning, go ahead and do your standing and stretching. But I would not go very far because as soon as they get here, they will want to take right off with the hearing.

The hearing is in recess.

[Recess.]

Chairman SHELBY. The hearing will come back to order.

Mr. Cooper, if you will proceed, just like we never went to vote. Thank you.

STATEMENT OF ROY COOPER
ATTORNEY GENERAL
DEPARTMENT OF JUSTICE, STATE OF NORTH CAROLINA

Mr. COOPER. Thank you, Mr. Chairman, and Members of this esteemed Committee. Thank you for allowing me to be and addressing this critical issue.

One spectacular result of these sweeping new rules proposed by the OCC is the rare harmony being sung by State attorneys general across the country.

Chairman SHELBY. Is that all 50?

Mr. COOPER. All 50 of us are on the same page.

Chairman SHELBY. Democrats and Republicans——

Mr. COOPER. Yes, sir, bipartisan.

Chairman SHELBY. —on the same page?

Mr. COOPER. Yes, sir.

These rules are wrong both as a matter of law and as a matter of public policy. I have submitted my written comments that discuss my objections, and let me quickly outline the major ones.

First, these rules significantly diminish important protections for American consumers. Second, they undermine creative and State efforts to combat predatory lending. And, third, they ignore Congressional intent and misinterpret Supreme Court precedent.

Simply put, these new OCC rules put consumers at risk by taking 50 cops off the beat. That is absolutely the heart of the matter. Thousands of State attorneys general's staffers across the country are helping consumers with their problems, mediating disputes, and securing refunds for people who have been wronged. Over the years, most State consumer protection laws were applied to national banks and their affiliates without controversy. There have been problems with some national banks, and State action has been taken.

National banks knew they were expected to abide by State law, and attorneys general provided the enforcement—until now. Now the OCC is saying we can do the job by ourselves. We alone can protect the tens of millions of national bank customers across the country.

That is simply not realistic. For the last 2 years, in North Carolina, my consumer office alone received over 1,000 formal written complaints regarding national banks, along with thousands more phone calls. And this is happening in attorneys general's offices across the country. We welcome the OCC to work with us in addressing these complaints, but the OCC cannot do this alone and do it effectively.

Now, although I do not believe the OCC wants its members to break the law, I have no confidence that they will provide adequate consumer protection by themselves. The OCC is actively recruiting banks into its fold, saying that they will not be bothered by State predatory lending laws. In addition, *The Wall Street Journal* recently documented how the OCC consistently sided with national banks and against consumers in recent legal disputes. Consumers must have the confidence that decisionmakers and regulators will be fair and that they will go to bat for them if they have been ripped off.

My next concern is that not only do these new rules undermine State predatory lending laws, but they also fail to address the most abusive practices forbidden by State laws. These include unjustified origination fees, deceptive discount points, excessive prepayment penalties, loan flipping, and financing of single-premium credit insurance. These practices are sometimes technical and difficult for the average borrower to understand, but there is a reason that the phrase "predatory lending" is used to describe them. In order to be effective, there must be specific restrictions under the law to fight each of these practices, and the OCC rules just do not do this.

Finally, I would like to counter very briefly some points the OCC makes when justifying these new rules. First, the OCC claims that it is merely exercising longstanding powers and codifying existing law. Do not be fooled. These rules are a dramatic change. They far exceed the preemption standard set by the Supreme Court in the Barnett Bank case, and they ignore specific Congressional acknowledgment of the role of States in regulating national banks.

The OCC also argues that these rules are necessary so that banks can operate under consistent, uniform national standards. The national banks do not need the OCC to insulate them from their obligation to be good corporate citizens in their respective States. When North Carolina passed our groundbreaking Predatory Lending Act, our national banks were right there at the table supporting the effort because they knew that predatory lending was a scourge that had to be removed. They saw the case of Freddie Rogers, a 56-year-old Durham school bus driver. For 10 years, he made his mortgage payments, but when he wanted to refinance because he had bad well water, he discovered that he had paid down only $165 on the principal. He was a victim of junk fees, unneeded insurance, and front-loaded payments—a predatory loan. And making $8.24 an hour, he could never get ahead.

Our predatory lending law in North Carolina works. Recent studies have shown the law has saved consumers over $100 million in the first year and that subprime credit is still readily available. The only lenders we have run out of North Carolina are those that are making predatory loans, and I say good riddance to them.

Our law has created a road map for lending practices across the country. For example, we were the first State to outlaw single-premium credit insurance, which was a useless product that overcharged consumers. It was considered controversial at the time, yet within 2 years, all major subprime lenders stopped offering this overpriced product to consumers.

We are now seeing lenders across the country voluntarily adopting a number of provisions of North Carolina's predatory lending law. Please do not let the OCC take away the effectiveness and the creativity of the States in fighting these problems.

In conclusion, as a State Attorney General, I know that my colleagues and I would vastly prefer a cooperative relationship with the OCC, just as we have with other Federal agencies. Unfortunately, with these preemption rules, the OCC has sought to eliminate that cooperation.

As attorneys general, we will not stand by and let these rules take effect without a judicial fight. But the best place to deal with this issue is right here in Congress. In fact, Senator Edwards from my home State has introduced a resolution to repeal these rules. I would assume that there are other Members of Congress who are looking at this effort as well. And I would encourage these efforts to let us step back and look at what we are doing.

Thank you very much, Mr. Chairman.

Chairman SHELBY. Mr. Gee.

STATEMENT OF GAVIN M. GEE
DIRECTOR OF FINANCE, STATE OF IDAHO
ON BEHALF OF
THE CONFERNECE OF STATE BANK SUPERVISORS

Mr. GEE. Thank you, Chairman Shelby, Senator Sarbanes, Members of the Committee. My name is Gavin Gee. I am the Director of the Department of Finance for the State of Idaho, and I am here today testifying on behalf of the Conference of State Bank Supervisors. We commend you on this important and timely hearing.

As you know, the OCC has recently issued sweeping regulations that seek to preempt almost all State laws that apply to national banks and their subsidiaries. This regulation also tries to shield all national banks and their operating subsidiaries from oversight, inspection, and enforcement actions by any State authority.

These regulations are not minor or incremental changes. Their scope is nearly unlimited, and their implications are potentially enormous. The OCC's new regulations usurp the powers of Congress, stifle State efforts to protect their citizens, and threaten not only the dual banking system but also public confidence in our financial services industry. If you allow these OCC rules to stand, our banking system and bank customers will be hurt.

Idaho is a small State with only about 1.3 million residents and bank deposits of about $12.5 billion. Although only one national bank is headquartered in Idaho, interstate branches of national banks account for about 70 percent of the State's banking assets. Therefore, most of the bank-related complaints and inquiries my office receives come from customers of national banks. We receive even more complaints about mortgage brokers, nonbank mortgage lenders, and finance companies, entities that are all likely to become operating subsidiaries of national banks in response to these new OCC regulations.

Idaho, like the vast majority of States, has not passed specific legislation against predatory lending. We have been very successful in enforcing existing laws that protect borrowers and punish fraud. Contrary to the OCC's argument, these laws have done nothing to interfere with credit availability in Idaho. But the OCC's regulations effectively preempt all of Idaho's consumer protection laws and law enforcement remedies, and those of every other State, regardless of whether that State enacted a predatory lending law.

Maintaining a local role in consumer protection and a strong State banking system has never been more important. State supervision and regulation are essential to our diverse, decentralized financial system. State bank examiners are the first responders to almost any problem in the financial system. We can and do respond to these problems more quickly than the Federal Government.

My office has a long history of protecting Idaho consumers from predatory or abusive lending and other financial fraud. We also have a long history of working cooperatively with national banks and their subsidiaries to resolve consumer complaints and inquiries. It cannot be in the public interest to replace this locally based service with one small office in Houston, Texas, as the Comptroller's regulations would do.

The OCC preemption would create an uneven playing field for national banks and State-chartered banks, and that concerns us.

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

States already have networks in place for referring complaints to the appropriate agencies and to law enforcement authorities when necessary. The States dedicate hundreds of employees to handling these consumer complaints, and these resources strain to keep up with the demand. With limited resources at both the State and Federal levels, we should be talking about sharing responsibilities, not preempting valuable resources.

This debate should not be about the protecting of or the advancing of one charter over another. It should not be about turf. It should be about creating the best structure for a financial services system that allows a wide range of financial institutions to compete effectively and make their products and services available to all segments of our Nation and that offers consumers protection and remedies against fraudulent and misleading practices, no matter the charter of the consumer's financial institution.

If Congress finds that Federal preemption is necessary to achieve this goal, we will accept that. With his actions, however, the Comptroller of the Currency is trying to cut off this discussion altogether.

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

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

Already on this panel you have heard conflicting certainties and conflicting fears. Having read the second panel's testimony, I expect you will hear more of the same. I assume that can only lead to confusion on this Committee and certainly among your constituents as to the implications of these rules.

Given this confusion, we have a request. We would ask that this Committee call on an independent source, such as the Congressional Research Service or a select task force, to review all of the claims and report to your Committee with their findings. In the interim, we would ask that the Committee and the Congress have the OCC rescind or suspend their rules. If the States are wrong, with the rules rescinded we merely have the status quo—a consolidating industry making record profits with a healthy and, for the most part, State-chartered community banking sector. If the States' concerns are found valid, then Congress will have prevented a serious change in Federalism with constitutional consequences that harm consumers, the banking system, and the economy.

Thank you very much, Mr. Chairman. I would be happy to answer any of the Committee's questions.

Chairman SHELBY. Thank you.

Generally speaking, shouldn't it be the Congress of the United States that would preempt something by statute, clearly do so, rather than a regulatory body that would attempt to do it by regulation, such as the OCC?

Mr. Cooper.

Mr. COOPER. Yes, sir, absolutely. We do not think that Congress has, in fact, preempted State consumer protection laws and predatory lending laws. That is a decision that you should make, not an unelected regulator.

Chairman SHELBY. Mr. Hawke, obviously you believe that you have that power to make a rule and that Congress gave you that power. Is that right?

Comptroller HAWKE. I believe that power comes from the Constitution, Mr. Chairman.

Chairman SHELBY. The Constitution.

Comptroller HAWKE. The Supremacy Clause of the Constitution says that the laws of the United States are the supreme law of the land, and the judicial history of preemption is based on exactly that.

Chairman SHELBY. How many national banks do we have in the United States?

Comptroller HAWKE. We have about 2,100 national banks.

Chairman SHELBY. How many State banks do we have?

Comptroller HAWKE. I think there are probably close to 7,000 State banks.

Chairman SHELBY. So, 2,100 and 7,000. Are some of our larger banks State banks?

Comptroller HAWKE. There are some. The Fed regulates a number of large State banks, and in Alabama, for example, there are a number of large State banks that are doing a broad multi-State business.

Chairman SHELBY. But, Mr. Hawke, if your regulations are upheld, would there be one standard for the national banks and one standard for the State-chartered banks?

Comptroller HAWKE. I think that depends on what the States do with respect to their laws. But that, Mr. Chairman, is really what lies at the heart of the dual banking system. There are Federal rules that apply to national banks and State rules that apply to State banks.

Chairman SHELBY. Mr. Cooper, do you want to comment on that? Doesn't that go to heart of it?

Mr. COOPER. It does go to the heart of it, and we are not saying that we have the right to come in and examine the safety and soundness of these banks. We do believe that is the exclusive prerogative of the OCC. But State consumer protection laws, these national banks which do business in our State historically have abided by State consumer protection laws. And we are not just talking about predatory lending, but do not call in other laws.

Chairman SHELBY. How do you answer the question that Mr. Hawke has proposed that his ability as Comptroller of the Currency to bring forth these rules or regulations to preempt the State laws comes from the Constitution, not from the Congress? And if it did come from the Constitution, just suppose, and if the courts upheld it, Congress would have no play in there, would it?

Mr. COOPER. Well, if you extrapolate, that means that any law that you would pass could apply and preempt——

Chairman SHELBY. But he is saying, he is rationalizing his ability to do these regulations, as I understood.

Comptroller HAWKE. In the absence of any action by Congress.

Chairman SHELBY. That is right, in the absence of anything.

Mr. COOPER. We think it is clear what Congress has done. Specifically, in 1994, in Riegle-Neal, you said specifically Congress should not prohibit the States from enforcing their consumer protection laws. We had the exact language in our written documentation. But we believe that you have spoken on this and that the U.S. Supreme Court has spoken on this issue.

Chairman SHELBY. Well, let us go back to the national versus State banks. You come from a State that is probably the second largest banking State in the Nation after New York—North Carolina. You have State banks and national banks. If this rule OCC has brought forth is upheld, what does that say to the North Carolina laws? They cannot be enforced against the national banks but you can enforce them against the State banks? Is that correct?

Mr. COOPER. That is correct, Mr. Chairman. We are very proud of our banking State in North Carolina, and we think clearly that other lending institutions will cry foul and will say here the national banks have this exemption from State predatory lending laws, we need the exemption as well. And what we fear even more is that these national banks will attract more banks because of this exemption from predatory lending laws.

Chairman SHELBY. Which would give them immunity in a sense, would it not?

Mr. COOPER. Correct.

Chairman SHELBY. What practical differences will consumers and national banks experience regarding the rules? In other words, could you provide us some before and after the rule? You are the Attorney General of North Carolina. How would you envision it?

Mr. COOPER. Right now you are seeing State attorneys general across the country take action against national banks and other lenders, and you would not see that enforcement action anymore.

Chairman SHELBY. Because they would not have a right to do it, right?

Mr. COOPER. That is correct.

Chairman SHELBY. But they would still have the right to go after the State banks for doing the same thing.

Mr. COOPER. That is correct. And that is fundamentally unfair.

Chairman SHELBY. Okay.

Comptroller HAWKE. Mr. Chairman, could I respond to one point?

Chairman SHELBY. Sure, go ahead.

Comptroller HAWKE. I think Riegle-Neal has really been misstated. I think Riegle-Neal demonstrates exactly the opposite.

First of all, since the beginnings of the national banking system, there has been an explicit Federal statute that says that the OCC has exclusive visitorial powers over national banks. Unlike the argument that the State AG's are making, there is no exception in that statute for nonsafety and soundness matters, like consumer protection. That is made very clear by Riegle-Neal.

Riegle-Neal, in the interstate branching context, says that State consumer protection laws will apply to national banks unless they are preempted, and that if they are not preempted, the OCC is the exclusive enforcement authority.

Within the last 10 years, Congress has explicitly addressed that issue, and it is simply not true, as the Commissioner said, that we preempt all State consumer protection laws. That is exemplary of the kind of gross exaggeration of what we have done that we are having to deal with. We do not preempt State fair lending laws. We do not preempt State unfair and deceptive practices laws. We address only those laws that deal with deposit-taking and lending, which are the essence——

Chairman SHELBY. Do you think you could preempt them under your constitutional power?

Comptroller HAWKE. Probably not. We have not considered that. But we have not preempted them. We are actually taking the position that——

Chairman SHELBY. In other words, where should the line be drawn?

Comptroller HAWKE. We are taking the position that they are not preempted.

Chairman SHELBY. Where should the line be drawn, Mr. Cooper, between State and Federal?

Mr. COOPER. State consumer protection laws that protect consumers should not be preempted by the OCC. We are not arguing with their powers to examine banks and make sure there is safety and soundness. But laws that protect consumers in the particular State should be obeyed by national banks, as well as State banks.

Chairman SHELBY. Mr. Hawke, just briefly, succinctly, restate the thrust of your legal analysis that your counsel came upon to determine where to draw the line.

Comptroller HAWKE. Our legal analysis traces back to the 1819 decision of the Supreme Court in *McCulloch* v. *Maryland,* which said that the States do not have the constitutional authority to restrict or limit or condition the powers that Congress has conferred on a Federally created entity. That is the ultimate basis for our preemption rule, plus many Supreme Court and other Federal court decisions since that time.

Chairman SHELBY. Your regulations, as I understand it, Mr. Hawke, contain a new predatory lending standard for national banks. Is that correct?

Comptroller HAWKE. That is correct.

Chairman SHELBY. Which prohibits them, that is, the national banks, from making "any type of consumer loan based predominantly on the bank's realization of the foreclosure value of the borrower's collateral without any consumer of the borrower's ability to repay the loan according to its terms." How does this standard differ, Mr. Cooper or Mr. Gee, from some of the State predatory lending standards that have been passed? Is it adequate or inadequate? I do not know.

Mr. COOPER. I think it is inadequate, Mr. Chairman. That is certainly something that should be done. Asset-based lending should be prohibited. All they have after that is general unfair and deceptive trade practices.

In my opening comments, I outlined all the specific problems that are faced with predatory lending, and you need to go through and specifically point out those problems.

In North Carolina, we found that our general unfair and deceptive trade practices act did not work. That is why we came forward and adopted our specific predatory lending law.

Chairman SHELBY. Mr. Gee.

Mr. GEE. Mr. Chairman, I certainly agree with General Cooper. The other thing I would add is that States right now, you have to remember that operating subsidiaries of national banks are generally State chartered. Many of them are State licensed. They are examined by the States. They are regulated by the States. They are overseen by the States. That has been the practice.

And so in those examinations you find, you know, violations, you find deceptive practices. The States have taken action in those cases, and that has benefited, obviously, national banks and their operating subsidiaries because, up until this regulation, they have been subject to State oversight and State supervision.

Chairman SHELBY. Can the OCC singlehandedly and sufficiently conduct oversight of national banks and their operating subsidiaries you referenced? Or will consumer protection suffer because of the lack of State resources and manpower?

Mr. Gee.

Mr. GEE. Mr. Chairman, from our perspective, we think the OCC does not have the ability and does not have the wherewithal to address consumer protection adequately. As I mentioned in my remarks and more in my written remarks, I come from a small State where there is no OCC office, no presence, to our knowledge. Consumers do not know about the OCC. They are not listed in the phone book. When they have a problem, they call our office. They call the State AG. They are not aware of the OCC, and we do not think that after these regulations the OCC is going to have a presence in a State like ours. And there are hundreds and hundreds of State examiners and the investigators and examiners with State Attorneys General's offices that are dealing with these problems on a day-to-day basis. We do not think the OCC has the resources to replace them.

Chairman SHELBY. Mr. Cooper.

Mr. COOPER. Mr. Chairman, the OCC is late to the consumer protection arena. Only in the year 2000 did they wake up and say, hey, we may need to start enforcing consumer protection rules here. The Senate might think this was laying the groundwork for preemption. What you are doing is taking away years and years of experience of State banking regulators and attorneys general's staffs who have experience in dealing with these consumer complaints.

You have seen a home loan, how thick it is. Going through each one of those papers trying to investigate wrongdoing by lenders is a lot of work, Mr. Chairman.

Chairman SHELBY. Mr. Hawke, do you want to respond to that? Can you do the job?

Comptroller HAWKE. We can do the job. And we do the job. We have enormous resources. We have hundreds and hundreds of bank examiners who have enormous clout over the banks that we supervise. We can get remedies. When matters are called to our attention, we can get remedies overnight in our banks, and we do not have to go to court and suffer the expense and delay of court actions to get remedies.

In Idaho, for example, where there are branches of five multi-State national banks, if we find problems in those banks, we can go right to the heart of the matter. We can go to the top of the organization and get corrections. And as far as people in Idaho not knowing what our telephone number is, there are literally tens of thousands of people around the country who are able to find our telephone number, and if they cannot, they are referred to us by the State authorities. We have an enormously effective consumer assistance group that processes 70,000 inquiries annually—complaints that come from all over the country, from all types of people. And it is a very effective operation.

Chairman SHELBY. Senator Sarbanes, thank you for your indulgence.

Senator SARBANES. Mr. Hawke, in your statement you say, right at the outset, that it is important not to lose sight of three fundamental points, and one of the points you do not want us to lose sight of it: "There is no evidence that they are the source of predatory lending practices." "They" being national banks. I am quoting you correctly, I take it.

Now, I would like to ask you: Does this statement include the operating subsidiaries of national banks?

Comptroller HAWKE. Yes, it does, Senator.

Senator SARBANES. Okay.

Comptroller HAWKE. And the State attorneys general bear that out.

Senator SARBANES. No, that is not my understanding.

Comptroller HAWKE. Well, that is what they have said. They may be saying something different today, but they have said that repeatedly in statements that they have filed.

Senator SARBANES. What is it they have said?

Comptroller HAWKE. They have said that the problems of predatory lending are problems that exist almost entirely in the unregulated segment of the financial services industry, and they are not problems that are found to any extent with national banks or Federal thrifts or their subsidiaries. That is their statement.

Senator SARBANES. Is that right, Mr. Cooper?

Mr. COOPER. I do not know what statement he is reading from, Senator.

Comptroller HAWKE. I can provide the statement.

Mr. COOPER. I think that may have been made by——

Chairman SHELBY. We would like to have it for the record.

Mr. COOPER. One of the attorneys general in the OTS issue, but I will back up and say that, yes, the majority of the problems have been with the finance companies. But there are problems with national banks, and, in fact, the only case that has been brought under the North Carolina predatory lending law—there was a class action case of consumers—was against a national bank.

You know, we hope that they can do the job, but why undercut us as well? And we are very concerned, too, that this recruiting process and with these subsidiaries that that is going to be attractive that they can skirt State predatory lending laws. So there is just no need to undercut State regulators here. We can work together. They can enforce, we can enforce, just like we do with other Federal agencies. And these banks are sophisticated, just like any other retailer.

Senator SARBANES. My understanding is that, first of all, that reference was in a different context and, in any event, was not as absolute as your statement. And I want to pursue your statement for a moment, Mr. Hawke. Let me just read it to you again: "There is no evidence that they"—meaning the national banks—"are the source of predatory lending practices." And you just said that you encompass within national banks their operating subsidiaries.

Has the OCC conducted a survey or study of the extent of predatory lending by national banks or their operating subsidiaries?

Comptroller HAWKE. We have not conducted a survey.

Senator SARBANES. Has the OCC conducted a hearing on predatory lending as a number of other governmental agencies have done?

Comptroller HAWKE. We have not held a hearing, but we have had an extensive rulemaking process, and we have sent out extensive guidance on the matter. We have also asked consumer groups and State law enforcement officials, both, to provide us with any evidence that they have of national banks or their operating subsidiaries engaging in predatory practices.

Senator SARBANES. Does the OCC know what percentage of national bank mortgage lending is subprime?

Comptroller HAWKE. I do not have that number at my fingertips, Senator Sarbanes, but subprime lending in national banks is a recognized subcategory of lending and——

Senator SARBANES. Do you know what percentage of national bank mortgage lending is subprime?

Comptroller HAWKE. I cannot tell you that.

Senator SARBANES. Does the OCC know the average points and fees charged by national banks and operating subsidiaries of national banks?

Comptroller HAWKE. No, we have not calculated——

Senator SARBANES. How do you make these flat-out judgments about no evidence of predatory lending practices when you do not know the underlying situation that would enable one to make that conclusion?

Martin Eakes, who is testifying on the next panel, the head of the Center for Responsible Lending in North Carolina, states in his testimony that has been submitted to the Committee, "The OCC ignores existing evidence of predatory lending within national banks, and their affiliates and subsidiaries. Despite some contradiction between this claim and the assertion that OCC has led pioneering efforts to shut down predatory lending, this claim is belied by allegations brought by consumer advocates and researchers regarding national banks."

Comptroller HAWKE. I do not know what Mr. Eakes is referring to. He talks about national bank affiliates, which are not subject to our jurisdiction. They are subject to holding company jurisdiction. I base my statement not only on the repeated statements of the State AG's, but also on the absence of any referrals of complaints or evidence from consumer groups or State law enforcement officials.

Senator SARBANES. Well, we will have Mr. Eakes here, and we will get his response to that.

Now, let me ask you this question. You cite as precedent for your preemption action preexisting OCC regulations and judicial preemption decisions. You also cite laws that have been determined to be preemptive for Federal thrifts by the OTS.

I take it that you are taking the OTS determination and just folding them in. Is that correct?

Comptroller HAWKE. We reflected the same scope that the OTS has embodied in its longstanding regulation on the same subject.

Senator SARBANES. I guess the answer to my question is, yes; is that right?

Comptroller HAWKE. Yes, Senator.

Senator SARBANES. The standard you cite is "obstruct, impair, or condition." You say that is the judicially established standard for Federal preemption.

The Barnett Bank decision, which we understand is the most prominent recent Supreme Court case on national bank preemption and which was cited in Gramm-Leach-Bliley, used the standard "prohibit or significantly interfere with a nationally bank's Congressionally authorized powers." Do you view the standard contained in your regulation as different from the standard in the Barnett Bank decision?

Comptroller HAWKE. No, I do not. There is a lot of language in Barnett, and people have tended to pick up one or two words from it, but I think Barnett completely supports the articulation of the standard as I made it.

Senator SARBANES. Do you have a view on that, General Cooper?

Mr. COOPER. We believe that their interpretation of Barnett Bank goes beyond significant impairment.

Senator SARBANES. Well, obviously you think—and, Mr. Gee, I guess you agree with this—that the Comptroller, to some extent, is taking the view, well, you know, I have not really done anything here. I mean, what I have done is just simply state what the lay of the land is. But no one seems to perceive it the same way as the Comptroller. I mean, everyone else seems to think he really has done something in terms of preemption, and I take it on the ground that is exactly the way it is working. In fact, I have been told that banks have been told just to ignore the attorney generals or the other State officials; is that correct?

Mr. COOPER. That is correct, Senator. I think recently they told them that it is okay for them to send forward the complaint to them and to take the complaint, but they reemphasized in that second letter that State attorneys general did not have the authority to enforce them. So here we are dealing with national banks with a complaint, and we have no authority to enforce our State law against a national bank. That is a concern.

Senator SARBANES. Mr. Gee, do you have any observation on that?

Mr. GEE. Senator, I would make the same observation. While the OCC did come out with guidance, and it is guidance only—it does not have the force and effect of a rule—clearly, the direction that national banks were receiving before, and there were a couple of well-publicized incidents where national banks actually told either State attorneys general or State bank commissioners, "We do not have to deal with you any more. We do not have to respond to you any more," and that is the message that has clearly been indicated to national banks.

Comptroller HAWKE. Senator Sarbanes, can I respond to that? There was some misreading of what we said, and we moved very quickly to clarify that. Our position should be understood very emphatically. We do not encourage our banks to stiff-arm State law enforcement authorities. We have advised them that when they get a consumer complaint referred by a State law enforcement authority or State attorney general, they should take it seriously, they should respond, they should provide information back as to the resolution of the matter. We have adopted special procedures in our Customer Assistance group to deal with referrals from State authorities.

We do not take the position that our visitorial powers rule, which is really based on longstanding Federal statute, it prevents State law enforcement authorities from calling a bank and referring a consumer complaint to them. That is simply not the case. What it does prevent is State law enforcement officials going to court to enforce a State consumer protection law against a national bank, and that is clearly grounded in Riegle-Neal and in the basic visitorial powers statute.

Senator SARBANES. Mr. Chairman, I see my time is up. I want to be fair to Senator Allard.

Chairman SHELBY. There will be another round.

Senator SARBANES. I will wait until the next round.

Chairman SHELBY. Senator Allard.

Senator ALLARD. Mr. Chairman, I want to follow up on the direction of your first question. Did you say that the Constitution is where you derive your authority and not from legislation that was passed by the Congress?

Comptroller HAWKE. What I meant, Senator Allard, is that the Congress has plenary power to deal with these issues however they see fit. But in the absence of——

Senator ALLARD. That is not entirely true either, but go ahead.

Comptroller HAWKE. I mean in terms of preemption. Congress can decide that a Federal law that confers powers on a Federal entity should not be viewed as preempting State law, and they do that all the time. There are many examples where they have done that. But in the absence of any expression by the Congress as to the preemptive effect of a Federal law, the case law, which goes back well into the 19th century, is very clear—that the Supremacy

Clause of the Constitution prohibits the States from adopting any law that restricts, impair,s or conditions the exercise of powers that Congress has conferred on a Federal entity, like a national bank.

Senator ALLARD. Well, but that is right. I mean, the Congress confers that, we do that through authorizing legislation.

Comptroller HAWKE. The Congress confers the power on the banks, and in the absence of any expression of intent by Congress that State law should be applicable to the exercise of that power, the Constitution preempts the State law.

Senator ALLARD. In other words, what are the limitations on how many rules and regulations you can pass? Is it your view that you can pass any law or regulation, as long as Congress does not tell you not to do it?

Comptroller HAWKE. Not at all, Senator. First of all, our regulation, in our view, and I do not recognize the description of it from some of the comments, does no more than codify longstanding principles. We have not created new standards of preemption.

Senator ALLARD. Here is what I am looking at. I have the Constitution here, and I am reading Section 8, 9, and 10. In Section 8, it says what powers Congress has and what powers the Federal Government has. It says what powers they do not have. And then in 10 it says what powers the States do not have.

And then I look over here in Amendment No. 10, the Tenth Amendment to the Constitution, "The powers not delegated to the United States by the Constitution nor prohibited by it to the States are reserved to the States respectively or to the people."

And I am trying to figure where you come up with your authority to be able to pass rules and regulations, unless it is authorized by the Congress of the United States.

Comptroller HAWKE. Senator, the Supremacy Clause of the Constitution says that the Constitution and laws of the United States shall be the supreme law of the land, and the Supreme Court has consistently interpreted that in the context of Federally created instrumentalities, like the national banks.

Senator ALLARD. I keep looking for that. The closest I can come to that is "to make all laws which shall be necessary and proper for carrying into execution the foregoing powers and all other powers vested by this constitutional Government of the United States or in any department or officer thereof." Is that what you are calling the Supremacy——

Comptroller HAWKE. No, that is not the Supremacy Clause, Senator. The Supremacy Clause says that this Constitution and the laws passed pursuant to it shall be the supreme law of the land.

Senator ALLARD. And where is that?

Comptroller HAWKE. I do not recall what section.

Senator ALLARD. I was going through here, and I did not see the——

Comptroller HAWKE. It is in there.

Senator ALLARD. What I do see——

Comptroller HAWKE. It is——

Senator ALLARD. I am not a lawyer.

Comptroller HAWKE. I have not practiced law for a long time.

Senator ALLARD. But I did not see anything with the kind of language that you are talking about. However, I do see specific powers granted to the Federal Government and to the Congress. I see specific powers denied them. I see specific powers denied to the States. And then I see an amendment here in the Constitution that says specifically, that any other laws that are not mentioned automatically go to the States and the individual.

It seems to me that you are really stepping out quite a ways on thinking——

Comptroller HAWKE. Senator——

Senator ALLARD. —you have all of these rules to promulgate——

Comptroller HAWKE. I, respectfully——

Senator ALLARD. There is not any authorizing legislation.

Comptroller HAWKE. I, respectfully, disagree, Senator. The Supremacy Clause says that the laws of the United States are the supreme law of the land. That is what the Supreme Court relied on when it said——

Senator ALLARD. What is the rule——

Comptroller HAWKE. Can I just finish my answer?

Senator ALLARD. Yes.

Comptroller HAWKE. That is what the Supreme Court relied on when they said that the States do not have the power to limit the exercise of powers that Congress has conferred on Federally created institutions. The Tenth Amendment does not reserve for the States the right to regulate Federally created institutions.

Senator ALLARD. I am not saying that.

Senator SARBANES. Is it your position that a State cannot effect, in any way, Federally created institutions?

Comptroller HAWKE. Since *McCulloch* v. *Maryland,* the law has been that the States, absent the conferral of explicit authority by Congress, do not have the power to condition, limit, or obstruct the exercise of powers that the Congress has conferred on Federally created entities like national banks.

Senator ALLARD. That is not the argument I am making, and I do not think that is the question that the Chairman was asking. Where do you get your authority to promulgate the rules? We are not talking about the Supremacy Clause and saying that the States have any authority over what you are doing, but we are talking about where you get your authority?

Comptroller HAWKE. We have explicit rulemaking authority under several statutes. One is the explicit power that Congress gave us to write the rules relating to the exercise of real estate lending powers by national banks, and there are other statutes that confer rulemaking power on us. But absent——

Senator ALLARD. I think that is the question.

Chairman SHELBY. In other words, what is the source of what you are trying to do? Because as I hear from the—thank you for yielding to me without asking.

Senator ALLARD. Mr. Chairman, any time.

[Laughter.]

Chairman SHELBY. Thank you, Senator Allard. But as I understand the Attorney General's Association, all 50 Republicans and Democrats have banded together and are going to challenge whatever you do here, and you are trying to do, your regulation, period. Is this correct, Mr. Cooper?

Mr. COOPER. That is correct.

Chairman SHELBY. Do you believe he has the basis he is talking about to do this?

Mr. COOPER. We do not believe that the——

Chairman SHELBY. That is what I was asking and it is what Senator Allard's——

Mr. COOPER. We do not believe that the combination of Supreme Court precedent and laws that Congress has passed allows him to do that.

Now, clearly, there is disagreement on what the law is. You guys can decide what the law should be. We can fight all day about this and probably will in court, unless Congress acts. And I think it is critical for you all to look at this, and I am glad that you are because you can say yea or nay on these rules, and I think Mr. Hawke would probably agree with that.

Senator ALLARD. Yes, I just wanted to get that clarified a little bit, Mr. Chairman.

Chairman SHELBY. You go ahead. Since you graciously let me take your time, you proceed.

Senator ALLARD. No, no. I took your question.

Chairman SHELBY. Well, you added to my question.

Senator SARBANES. Well, does Mr. Hawke agree that we can say yea or nay?

Comptroller HAWKE. Absolutely, Senator. The OCC is——

Senator SARBANES. It comes not from the Constitution, but from statute.

Comptroller HAWKE. The Congress created the national banking system. It can repeal it. It can do anything it wants with the national banking system.

Chairman SHELBY. Where does the Constitution come in? The Constitution will preempt the statutes of the United States Congress.

Comptroller HAWKE. The Constitution comes in, Mr. Chairman, when Congress has not spoken, when Congress has not specifically said State law should apply, and it has in many cases. When Congress has not said that State laws shall apply to a Federally created entity like a national bank, then the Constitution prohibits the States from acting to restrict or condition or obstruct the exercise of those powers that Congress has conferred on those entities.

Senator SARBANES. Which are the powers we conferred on the banks that constitute the basis of preemption of predatory lending laws.

Comptroller HAWKE. The basic power to conduct a banking business, the statutory power——

Senator SARBANES. So you believe the power to conduct a lending business embraces the power to conduct the predatory lending business; is that correct?

Comptroller HAWKE. Not at all, Senator, and I also wanted to mention——

Senator SARBANES. Well, if it does not embrace it, then why should the State not be able to act in the area of predatory lending? If it is not embraced, I do not see any of the basis for the preemption.

Comptroller HAWKE. If I could finish my answer, Senator Sarbanes——

Senator SARBANES. The State would be able to act.

Comptroller HAWKE. If I could finish my answer, the Congress has explicitly provided that national banks can make real estate loans under rules that the OCC has determined, and we have issued such rules. What the State antipredatory lending laws do is impose conditions on the exercise of the power to make real estate loans by national banks.

I am not trying to justify predatory lending. We have ample power to deal with predatory lending where we find it. What I am saying is that the Constitution does not permit the States to adopt rules that condition or limit the exercise of real estate lending powers by national banks. Congress can change that, if it sees fit. Congress can adopt a national predatory lending standard that applies to the real estate lending powers of all banks. But in the absence of that kind of law, the constitutional principle operates.

Senator SARBANES. Well, except the OCC is the one that is putting forth the regulation. The fact of the matter, we have been talking about power, but there is also the question of the wisdom of what you are doing, over and above—there is nothing in the Constitution that compels you to do this. So, in a sense, we are back to the wisdom of what you are doing, about which everyone is sounding an alarm bell.

Comptroller HAWKE. Senator, I do not have the ability to apply the constitutional principle based on my own judgment about whether a particular law is a desirable one or an undesirable one or a good one or a bad one. The constitutional principle operates, and it has operated for almost two centuries in our history.

I should say that these preemption issues are raised all the time in the courts. One of the reasons that we put out this rule was to try to bring some clarity to the subject. We win these preemption cases all the time. When we preempted the Georgia antipredatory lending statute, the Georgia attorney general was asked to take us to court, and he reviewed the precedents and said that he thought there was so little chance of overturning us in court that he would not even sue us.

So, if the State attorneys general want to test these issues in court, I think that is perfectly appropriate.

Chairman SHELBY. Senator Carper, thanks for you indulgence.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Not at all.

Welcome Mr. Gee, Mr. Cooper. Mr. Gee, are you the bank commissioner for your State?

Mr. GEE. Yes, Senator, I am.

Senator CARPER. What do they call you back there—commissioner? Commissioner Gee?

Mr. GEE. Director.

Senator CARPER. Director Gee. Are you appointed by the Governor or how do you serve?

Mr. GEE. Yes, I am, Senator.

Senator CARPER. Governor Dirk Kempthorne?

Mr. GEE. Yes.

Senator CARPER. You tell him an old Governor from Delaware sends his best.

Mr. GEE. I will do that, Senator.

Senator CARPER. Mr. Cooper, where are you from in North Carolina?

Mr. COOPER. I am from Rocky Mount.

Senator CARPER. Are you, really?

Mr. COOPER. On I–95, yes, sir.

Senator CARPER. My wife is from Boone, up in the mountains, and we have a lot of family up there in Watauga County and down around Cary and Holly Springs.

Chairman SHELBY. Everybody knows why Senator Carper carries all three counties in Delaware.

[Laughter.]

Chairman SHELBY. All of them.

[Laughter.]

Chairman SHELBY. Go ahead.

Senator CARPER. We have not carried any counties in North Carolina yet, though.

Chairman SHELBY. There are just three.

Senator CARPER. I am glad you are here and look forward to working with you.

Was Governor Easley your predecessor?

Mr. COOPER. Yes, he was.

Senator CARPER. Mr. Hawke, how are you doing?

[Laughter.]

Comptroller HAWKE. Well, I hope I feel as good when I leave as I did when I came in.

Senator CARPER. We hope so, too. We appreciate your being here. We appreciate all of you being here.

A person who is not here is Senator Zell Miller, and he has shared with me, the staff has actually shared with me a note from him, and I am going to just go ahead and ask this one on the record. I will just read it, rather than paraphrase it, since it is not very long. It is from Senator Miller to Mr. Hawke. It deals with a letter that was written to you—you may have heard of this—a letter that was written to you by the bank commissioner, I guess by Director Gee's counterpart in Georgia.

It was written to you back on August 21, 2003, requesting clarification on several matters relating to the OCC's preemption. Apparently, Zell Miller's staff got involved in February of this year because the State bank commissioner had not received a response to his or her August 21 request. And, finally, the response came to the commissioner of Georgia on April 2, 2004, which is probably about 8 months after it was made.

There may be a perfectly good excuse for the delay in that kind of response. We got our mail lost after the anthrax attacks and ricin attacks. Some mail gets lost for months, and maybe you have a similar problem, I do not know. But just for the record could you tell us why it took so long to respond to Commissioner Sorrell.

Comptroller HAWKE. There is no excuse for that, Senator Carper. I learned about this several weeks ago. I was extremely upset. This is not the way we should be treating inquiries from State officials. Frankly, it is black mark on our record. I called Commissioner Sorrell the other day and told him that we would have a letter to him the next day, and we did. I am deeply regretful that that incident occurred, and I have apologized profusely to him about it.

Senator CARPER. Thanks very much. We will convey that to Senator Miller.

The reason why I was willing to raise this, on behalf of Senator Miller, is that it relates to a question I am going to ask of Director Gee and General Cooper, and particularly to Director Gee.

In our State, as the Chairman says, we are a pretty small State. We only have three——

Chairman SHELBY. A very important State, the first State.

[Laughter.]

Senator CARPER. I yield to the Chairman for however much time he wishes to consume.

[Laughter.]

Chairman SHELBY. Any time you want.

Senator CARPER. We focus a lot in my Senate office, we did when I was governor of Delaware, and our bank commissioner's office focuses a lot on constituent service, being able to respond in a timely way to the people who inquire on particular issues.

How does it work in Idaho? You are not a little state geographically, but you are a fairly small State, in terms of population, like us. But how would constituents, consumers, if you will, who had a gripe or a beef or a concern with a practice of a nationally charted bank, how would they have acted or behaved in your State prior to the promulgation of this rule and how might they be expected to take their beef or complaint or gripe now under this new rule? How has it changed?

Mr. GEE. Thank you, Senator, for the question.

The difference is, before the rule, as I mentioned in my testimony, most consumer complaints do come to our office or the Attorney General's Office. Whether it is against a national bank or a national bank subsidiary, those complaints and inquiries come to our office. This is especially true when there is some type of major transaction involving a national bank; for example, a merger or consolidation, acquisition, closing of a branch office.

Those kinds of major transactions generally facilitate a lot of complaints or inquiries to our office. And before this rule went into effect, our office responded to those complaints. Our office has a very good working relationship with the national banks that operate in our State. We have contact people in all of those national banks. We work out the resolution of those complaints with those contact individuals. Quite often they will make restitution or resolve the complaints in an appropriate way.

The operating subsidiaries quite often, as I mentioned, are actually regulated by either our State or other States licensed by the States and overseen and examined by the States. After this rule goes into effect, we have lost all of that power and authority to regulate operating subsidiaries of national banks. We no longer have jurisdiction. A lot of those companies not only in our State, but around the country, are turning in their licenses to the States.

States no longer have jurisdiction to respond to consumer complaints or inquiries or any authority over those operating subsidiaries. And it is primarily those operating subsidiaries is where our concern about predatory lending and other abusive lending practices occur, and we have lost our authority. The attorney generals have lost their authority. The attorney general in our state has lost their authority with respect to those operating subsidiaries and also complaints against the national bank.

We no longer have authority, under our State's consumer protection laws or other laws. Generally speaking, as the Comptroller points out, there are some laws that still apply, but, as a general rule, if you look at all of the actions, for example, the attorney general in our State over the last 3 years, has brought three major enforcement actions against national banks.

Those actions now cannot be brought under the consumer protection laws of our State. Those have been preempted by these regulations. So our ability to help consumers, resolve their complaints, whether it is the national bank, and especially the subsidiaries of national banks, has been preempted.

Senator CARPER. If I could ask General Cooper a similar question, then, Mr. Hawke, I am going to ask you to respond as well. I am going to give you extra time, if we could.

Mr. COOPER. Senator, let me state clearly, and I think the director may agree, we do not concede that these new rules take away our authority because we are going to fight this every step of the way in court. We believe you can do something about it now, but we do not concede that in expressing our concern to you.

But right now thousands of North Carolina consumers call my office because they want help. I testified earlier that we receive thousands of phone calls regarding national banks and that in the last 2 years, we have received about a thousand written complaints regarding national banks, and they file these complaints because they believe that I have the authority to do something about it.

If the OCC ultimately is successful here, I will not have the authority to do something about it. What I said earlier is this takes 50 cops off the beat. We believe that they have the authority, and we have the authority. We should both have the authority because there are enough problems that are around regarding these issues where we all need to be involved in protecting consumers.

There are numerous examples where Federal authorities and our offices work closely together. We have even had that with the OCC in the past. We want to continue that, but do not take away our authority.

Senator CARPER. Mr. Hawke, in responding, let me just——

Comptroller HAWKE. Senator——

Senator CARPER. But before you say it, one of the concerns that I have, and it is really underlined by what was shared with us by Senator Miller was, you know, if you happen to be a constituent in Idaho or a consumer in North Carolina, Delaware, Maryland, or Alabama, and if the State Bank Commissioner of Georgia has to wait 8 months for a response, what can a consumer expect?

Comptroller HAWKE. The failure of us to respond in Georgia was a unique situation and something that I apologized for.

Consumers do not have to wait, and law enforcement officials do not have to wait. For the day-to-day complaints that consumers have, and Members of Congress know only too well, they hear from their constituents about a variety of things. We hear 60,000 or 70,000 times a year from customers of banks, not just national banks, about the kinds of everyday problems they have with their banks. Fifteen thousand of those we refer back to other agencies because they do not apply to national banks. We have an enormously effective system of getting complaints to the right people.

We receive hundreds and hundreds of complaints from State law enforcement officials in that process. Nothing that we have done in our new regulation prevents the attorney general or his staff in North Carolina from calling a national bank and saying, "I have got this complaint. What is this all about? Can you get this fixed?"

What Federal statutes do prohibit, and this has been the case since the beginning of the national banking system, and it was reinforced 10 years ago in Riegle-Neal, is State attorneys general taking administrative or judicial enforcement actions against national banks. The law is absolutely clear on that, in my view, and I do not think it is a close call. We are happy to have that tested in court because I think it is very clear, and we have won that case in court on several occasions.

The important thing here, Senator, is getting customers' problems solved. And I think that if we take a cooperative and coordinated attitude about these things, we can get that done.

The Attorney General of New York recently filed a lawsuit against the subsidiary of one of our national banks. That suit will go on for months, if not years. When we found out what the customer's complaint was, we called the bank and got it fixed overnight. We had a similar complaint last year from another bank that came into our customer assistance group. They called the examiner in charge of the bank. He went down the hall to the bank's consumer affairs person, and the problem was fixed immediately.

When a bank examiner goes to an officer of a bank with a customer complaint, he or she has enormous influence to get those things resolved. If we could work together with the States and use our clout though examiners, use our customer assistance group, use the very far-reaching enforcement powers that we have, we could all do a better job of solving the problems of consumers. This should not be a competitive game. It should be a cooperative game.

Senator SARBANES. Do you apply that line of thinking to State-chartered operating subsidiaries of national banks?

State-chartered operating subsidiaries of national banks, do you apply that line of thinking to them?

Comptroller HAWKE. Absolutely, Senator. And this is another issue that——

Senator SARBANES. The State, it has no reach over them, even though they come in for a State charter?

Comptroller HAWKE. They are organized under State corporate laws, and they are licensed by us to carry out Federally granted banking powers. Operating subsidiaries can only do what the parent bank can do, and they are carrying out their Federally granted powers. This case has been litigated at least three times. In each case, our view on this has been upheld. There are two cases pending now in which the same issue is being raised, and we are awaiting decisions.

This is a lawyer's issue. We will either win it or lose it. It is not going to be the end of the world one way or the other. But, I think our position on this one is absolutely sound, and we have had three court decisions that have agreed with us on that.

Chairman SHELBY. Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. Once again, thank you and Senator Sarbanes for holding a timely hearing. I thank our witnesses.

I think this is a very interesting issue, and obviously you have two conflicting values at hand. On the one hand, as we move into the 21st century, financial markets tend to be national. We have had some of the insurance industry come to us and say they want a national charter because they do not want to go through 50 States to get every new regulation approved. They have a new annuity product. Even when they have friendly regulators, they do not want to take the time.

On the other hand, we have always had a Federal system. And as I think it was Judge Brandeis said, the States are the laboratories. And when you go preempt, you undercut the States being laboratories. And so I think there is not a clear-cut answer. I tend to think, on pure financial issues, the way money flows back and forth, and those kinds of things, you tend to have a Federal bias. But it seems to me on consumer issues, particularly where different practices occur in different States, your ruling is going to have an adverse effect, and I am troubled by it.

I am also troubled, as I know the Chairman, and Ranking Member, and others were, that you rushed to judgment before we could have hearings. This seemed, to me, to be an ideal issue, and I have great respect for you, and we have known each other maybe close to 2 decades in these banking areas, but this is an ideal area where hearings should have occurred because of these conflicting values.

Take the issue that has raised the hue and cry in my State, and that is the predatory lending. It may well be that predatory lending is only endemic in a few States—certainly when it starts. Those States become what Brandeis calls the laboratories, and we see, as they pass laws, how well they work. And that is what has happened with predatory lending. There have been a few States that have been way ahead of the game.

In New York, we have laws that protect consumers from balloon payments, increased interest rates after default, loan flipping, negative amortization, oppressive mandatory arbitration clauses, lending without due regard to repayment ability, and financing of points and fees in excess of 3 percent of the loan amount.

You point to an example where our State attorney general brought an issue and you solved it. But I have to tell you, I have been around for 20 years, and let me tell you, for even a Senator or Congressman to knock on the OCC's door and say we have a problem and get quick action, when it is a local problem in particular, does not happen very often.

Senator SARBANES. If at all.

Senator SCHUMER. If at all. So maybe that happened once, but this is our experience. You know, you are busy with a million other things. This is not your jurisdiction.

My question to you is, now, what is going to happen in New York State if, in New York State, there are serious problems of the types I listed, with heavy penalties, including allowing the mortgage to be void, does the OCC have identical protections? What are you going to do in the event that a complaint is issued against the lender on some of these violations that I have mentioned?

Comptroller HAWKE. Well, two things, Senator Schumer.

First of all, in our preemption regulation, we set out what I think is an extremely important standard that goes to the heart of predatory lending. That is what I call the underwriting standard.

Second, we made clear——

Senator SCHUMER. Wait. Can you elaborate? How does the underwriting standard deal with something like loan flipping?

Comptroller HAWKE. The underwriting standard does not expressly deal with loan flipping.

Senator SCHUMER. Does it deal with balloon payments?

Comptroller HAWKE. No, but we have addressed those in other contexts.

Senator SCHUMER. Well, tell me how.

Comptroller HAWKE. First of all, we put out very extensive advisories to national banks on these very practices that are associated with——

Senator SCHUMER. And if they violate the advisories?

Comptroller HAWKE. We will go after them for unfair and deceptive practices under the Federal Trade Commission.

Senator SCHUMER. How many have you begun to look into in New York since February 12?

Comptroller HAWKE. I cannot tell you what——

Senator SCHUMER. Could you get that back to me?

Comptroller HAWKE. Sure. We have gone after——

Senator SCHUMER. The bottom line, sir, is this is an awful and serious problem. It is generally done not by the major banks, but by lots of others. It is done by the smaller ones. They will go seek a national charter because there will be a lesser regulation there, and, I mean, let us be real here. It is going to take years before you go after them.

Furthermore, it is my understanding the OCC, you know, that it was never my understanding that you had the authority to define unfair or deceptive acts. Do you?

Comptroller HAWKE. We do not have the authority to adopt rules. The Fed has the exclusive rulemaking authority, but we do have the authority, on a case-by-case basis, using years and years of Federal Trade Commission precedent to go after banks for unfair and deceptive practices. And we have done that. We have done that.

Senator SCHUMER. So, on balloon payments, if there were this serious problem with these huge balloon payments, and poor people who finally were able to buy a house. You know, they pay the mortgage for 2 years, and then there is this big balloon payment, and no one ever explained to them adequately that that is what was going to happen, what would happen? Let us say we found some small national institution doing this repeatedly, would you have to go to the Fed first to get permission?

Comptroller HAWKE. No, not at all. And balloon payments are not inherently unfair or deceptive or illegal. They have to be looked at in context.

Senator SCHUMER. No, but let us say in the case of this bank they were deceptive, and a guy making $20,000 a year was able to pay $200 a month, and then in the third year he had to pay $1,000 a month.

Comptroller HAWKE. We could go after them using our unfair and deceptive practices authority, and we would if it came to our attention.

Senator SCHUMER. Can you tell me how many balloon payments in the history of the OCC you have gone after?

Comptroller HAWKE. I cannot tell you that we have gone after balloon payments as such, but we have gone after——

Senator SCHUMER. It is not balloon payments. The point being we are all in the real world here, and we all know, having dealt with the OCC for a long time what you do very well and what you do not do all that well. And going after smaller institutions, the bottom-feeders in a certain way, that do some of these horrible things has never been an OCC strength. And we all know it takes a very long time. It takes time to convince people to even look at something new. That is what is so frustrating here.

Now, you come in, without waiting for the Chairman's admonition to let us have some hearings and ask you maybe we would open a window of your thinking, and you just go preemption. And I have got to tell you, even though I tend to believe in national powers, as I say in financial things, I do not think that that is an across-the-board statement and should be an across-the-board view.

I have to tell you, I think the OCC has hurt itself by doing this.

Senator SARBANES. Badly.

Senator SCHUMER. I have to tell you, and I would hope you would even reconsider and maybe sit down with us. I mean, this Committee is hardly known as a radical Committee.

[Laughter.]

And to not sit down with us and try to figure out how to deal with this fairly, and sit down with others, instead of just doing this, I would strongly urge you to do it. You have created an outcry, and it is not on everything. It is not on even the idea of a national banking system. Again, I know the State regulators all want to have as much say in this brave new world. They should have less say than they used to. But there are certain areas, particularly consumer and predatory lending, which are different in different States, that do not interfere with the national banking system at all, that you should be leaving it up to the States, and that is the trouble with a blanket resolution.

Just explain this to me. Who defines what an unfair and deceptive action is, and what is your definition of it? That is a very broad term.

Comptroller HAWKE. It is a very broad term. It is like unsafe and unsound banking practices. The Federal Trade Commission Act gives the Federal Reserve the exclusive authority to write across-the-board rules. They have done very little in that respect.

Senator SCHUMER. Right.

Comptroller HAWKE. We asserted the right to take individual actions—this is something no one else had ever done before until very recently—and we have taken a number of actions where we issued cease-and-desist orders and remedial orders for violations of the Federal Trade Commission Act. And we have decades of precedents from the Federal Trade Commission as to what constitutes unfair and deceptive practices.

Senator SCHUMER. Do you think anyone out there in the banking world knows what you think they are?

Comptroller HAWKE. If they read what we say, they should know, because we have described it in our advisories on predatory lending.

Senator SCHUMER. Right. Somebody has told me, since 2000, you have taken a grand total of five enforcement actions. Does that sound correct?

Comptroller HAWKE. The first time we asserted this authority was very recently. It had gone unused for many, many years until we took the position that we had the authority to do it.

Senator SCHUMER. Well, I would posit to you that, A, there are probably many more than five violations since 2000 and, B, if the 50 States could be involved in some of these areas—I do not know what the five were—you would get a lot more enforcement without—underline "without"—interfering with the need for a national banking system and the fact that banking has become much more of a national business than it was before.

Someone showed me the list here. Here is one of them. One bank in Marin County, I guess, did not inform customers of extremely low credit limits. Another one did not disclose application fees. Providian, it says multiple deceptive marketing practices.

Comptroller HAWKE. We got a $300-million restitution judgment against Providian.

Senator SCHUMER. But the others——

Senator SARBANES. Who brought that action, the Providian action? Who brought it?

Comptroller HAWKE. We brought it jointly with the local law enforcement authorities.

Senator SCHUMER. Who was first?

Comptroller HAWKE. We brought it together.

Senator SARBANES. That is not my understanding.

Chairman SHELBY. Let Mr. Cooper answer that.

Mr. COOPER. It is my understanding that the local district attorney there in California began investigating it and later was joined by the California Attorney General and the OCC, and that it was a team effort because they all——

Chairman SHELBY. But it was initiated locally or State.

Mr. COOPER. That is correct.

Comptroller HAWKE. It was a team effort, but we got a nationwide remedy, and what they got was a local remedy.

Senator SCHUMER. Well, but——

Comptroller HAWKE. Senator Schumer, if I may——

Senator SCHUMER. Please.

Comptroller HAWKE. —take off on your point about the national scope of financial services. In a State like Massachusetts, for example, 75 percent of the mortgages originated in that State are originated in offices of banks that are headquartered out of State. When we find problems in a local office of a bank like that, we can get a centralized remedy against that institution that covers their operations nationwide, and that is something that nobody else can do.

Senator SCHUMER. But, sir, without your preemption, you could do the same thing. You could have done just what you did with Providian. As the local began to look at it, you could then join them. In fact, I would argue, if I were the San Francisco or if someone, Mr. X, were the San Francisco D.A., after this ruling, he would say, Look, I think this is horrible, but there is nothing I can do about it other than go knock at the door of the friendly OCC and hope that they will listen to me.

Comptroller HAWKE. The State's action in Providian was against the holding company. Our action was against the bank.

Senator SCHUMER. I understand, but——

Comptroller HAWKE. And we joined together very effectively to get a——

Senator SCHUMER. Can I just ask, it may have been asked, why did you rush this thing through and not wait for hearings?

Comptroller HAWKE. Senator, we had had an extensive rulemaking proceeding on this. We believed that the legal precedents were absolutely clear. We were facing great uncertainty in the marketplace. The States were increasingly adopting laws that they attempted to apply to national banks. There was an increasing amount of litigation. We have had 4 dozen lawsuits.

Senator SCHUMER. But would it not have made sense, sir, since we have somewhat of a different experience than you, just because we see different parts of the world, that before you did this, you came, you heard our viewpoints, maybe you would have passed a better rule? There is a feeling, I guess I have it, and I do not think I am alone here, that there was a rush to almost avoid us looking at this, making suggestions, et cetera, that you better get this done before the heat continues to build.

And as I said, for a man of your distinguished record, I do not think you served your institution well by doing this, even if some change might have been warranted.

Chairman SHELBY. Thank you.

Comptroller Hawke, you are not here every day. I am going to move on to something outside the parameters of the scope of this hearing and just as important.

Comptroller HAWKE. I will be back in 2 weeks, Mr. Chairman.

Chairman SHELBY. This has to do with the Bank Secrecy Act compliance. The public has been reading about the failure of Riggs Bank to comply with the Bank Secrecy Act, especially in the area of failure to file Suspicious Activity Reports, called SAR's. You are aware of all of this.

We are aware of the July 16, 2003 consent order issued by agreement between your office, the Office of Comptroller of the Currency, and Riggs Bank. The order required Riggs to significantly improve and upgrade its compliance, internal controls, and audit functions concerning Riggs' duties under the Bank Secrecy Act, within 60, 90, and 100 days, respectively.

Can you provide the Committee a brief overview of how the issue of BSA—Bank Secrecy Act—compliance is handled by our examiners. Specifically, do the examiners look at a general program, a list of activities or programs the bank engages in? Do the examiners ever look at individual transactions to gauge a bank's compliance with the Bank Secrecy Act?

Has Riggs met the deadlines established in the order that I referred to just a minute ago? Are you satisfied with their progress as the Comptroller of the Currency to date? And given the emphasis—I know this is a lot, but this is important—on the SAR's, the Suspicious Activity Reports, as a tool that would allow bank examiners, your bank examiners and others in the Government, to gauge whether the integrity of the banking system is being exploited by criminals and terrorists?

Is the OCC adequately resourced, trained, and staffed to examine the banks, under your jurisdiction, to fully inspect their compliance with the Bank Secrecy Act? And you have recently named, I believe, is it Mark Levonin—is that his name? L-e-v-o-n-i-n—as the Deputy Comptroller for Modeling and Analysis, a new position. Do you see his duties as including a quantitative analysis of the risk created within the banking community for failure to comply with the Bank Secrecy Act requirements?

To better explain, will this gentleman, with his new post, create models which will allow the Office of Comptroller of the Currency—your office—and others within the Government to focus limited resources by using models to identify banks which are most at risk to be used for illicit purposes, including criminal activity and especially terrorism? You are very familiar with this order, I know.

Comptroller HAWKE. If we may, Mr. Chairman, submit a response to those questions in writing, I would be pleased to do that.

Chairman SHELBY. Will you do this, and will you do it soon?

Comptroller HAWKE. Yes, sir.

Chairman SHELBY. Because this is a current object of concern to not only this Committee, as the Banking Committee of jurisdiction over this, but what people are reading and hearing and we know has been going on.

Comptroller HAWKE. We will turn right to that.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

I know we have another panel, and we need to move along, but, Comptroller Hawke, where does your budget come from?

Comptroller HAWKE. It comes principally from assessments that we levy on national banks.

Senator SARBANES. So the more national banks there, and the larger they are, the more potential you have for a bigger budget; is that right?

Comptroller HAWKE. Our assessments are based on assets, and there is a sliding scale of assets, so there is a relationship between the volume of assets we supervise and our assessment revenue.

Senator SARBANES. When the OTS did its preemption ruling, did some financial institution subsequently shift their charters into charters that brought them under the jurisdiction of the OTS instead of State or Federal banking authorities?

Comptroller HAWKE. Conversions occur quite frequently, Senator. I cannot pinpoint whether a conversion of a national bank to a thrift or vice versa occurred in particular relationship to an OTS regulation.

Senator SARBANES. Well, you have been concerned about your budgetary situation. I believe I think I can remember you testifying at the table on previous occasions that you were not getting the same number of institutions of the same size and that that was creating budgetary problems for you.

Comptroller HAWKE. Not at all, Senator. Our budget has been in extremely good shape during all of the years that I have been Comptroller. It has been well-balanced. We do not spend everything that we get. We have created a significant contingency reserve.

What I had addressed this Committee about before was the enormous inequity that exists between State and national banks because the Federal Reserve and the FDIC, in effect, provide a billion dollars a year in subsidy to State banks by absorbing the cost of their supervision. National banks pay the full cost of their supervision. State banks pay about 20 percent of the cost of their supervision, and I think that is an inequity that should be addressed. That is one of the principal recruiting devices that the States use in trying to persuade national banks to convert to a State charter.

Senator SARBANES. *The Wall Street Journal* has an article in which they say, speaking about you, "Still, he does not apologize for using the OCC's power to override State and local laws designed to protect consumers. Enjoying this aid provides an incentive banks to sign up with the OCC. He says it is one of the advantages of a national charter, 'and I am not the least bit ashamed to promote it.'" Actually, they put that part of it in quotation marks.

Comptroller HAWKE. Yes. There is no question, Senator, that preemption is an important attribute of the national bank charter, and I am a strong believer in the quality of the national bank charter.

Senator SARBANES. Now, you seem to be getting some pretty quick results. I gather that on March 22, HSBC announced that it was going to apply for a national shift from a New York charter, but to a national charter; is that correct?

Comptroller HAWKE. Yes. HSBC is a very sophisticated organization that knows all of the rules. Their decision on charter choice is something that takes a lot of factors into account. I should point out that HSBC was a national bank until about 10 years ago, and 5 years ago they acquired a large national bank in New York. They know what the value of the national bank charter is, and they have made a decision, on their own, based on a variety of corporate considerations.

Senator SARBANES. Mr. Chairman, I am going to quote from it a little bit, and then I would like to include in the record——

Chairman SHELBY. Without objection.

Senator SARBANES. —a statement put out by the Conference of State Bank of Supervisors with respect to this HSBC announcement that they were filing an application with the Office of the Comptroller of the Currency to convert its U.S. bank operations from its New York charter to a national charter. Thereby, highlighting the State's serious concerns about recent sweeping preemptions from the OCC for national banks and their subsidiaries.

They all go on to say:

> We are encouraged that HSBC has indicated that it intends to maintain Household, HFC, as a State-licensed affiliate, in compliance with State laws and the historic settlement with State attorneys general and banking departments.

And we know something around here about the practices of Household that led to those.

> However, the loopholes created by the OCC's recent regulations preempting State consumer protection licensing and enforcement laws, unfortunately, create incentives to do otherwise.
>
> In January, the OCC unilaterally preempted State laws regulating the operating subsidiaries of national banks. That action has created opportunities for financial institutions to escape State supervision and State enforcement while effectively operating outside of the national bank.
>
> If the OCC's regulations stand and HSBC were to convert Household to an operating subsidiary, they could shield Household from enforcement of the agreement it reached with the States. This change in structure would require not much more than a move on HSBC's organizational chart. Household would still be a State-chartered corporate entity, but the State's authority would be voided.
>
> While the OCC's regulations may seem esoteric, the consequences are very real for American consumers.

And I want to inject my own comment at this point here. You said earlier, when we were having a discussion, well, these are lawyers' issues you said, when we were arguing about the preemption. They are people's issues. You might characterize them as lawyers' issues, and they may get resolved in a judicial proceeding, but the impact of them are on people, real, live people, many of whom are exploited and taken advantage of.

This statement goes on to say,

> According to the OCC, the States no longer have the authority to investigate or enter into enforcement agreements with an entity like Household if it is a national bank or a State-chartered operating subsidiary of a national bank.
>
> This makes no sense to the American public. State financial regulators and attorneys general have been at the forefront of pursuing predatory lending and a host of other consumer abuses. We believe the local accountability must be a part of our Nation's new and rapidly evolving system of nationwide financial services. As an organization, the Conference of State Bank Supervisors is committed to a system of financial regulation that is responsive to consumers at the State level, while also evolving to provide a rational environment for all financial institutions, large and small, to operate.

That seems to me to be a good, common-sense statement, and I think it, in part, explains why there is so much concern about the actions you have taken.

Thank you.

Comptroller HAWKE. Let me just say, on Household, we are not contemplating doing anything that would change the applicability of the settlement agreement. The Household entity that is the subject of that agreement is a holding company subsidiary and not part of the bank.

And on this issue, Senator, of operating subsidiaries, I want to point out again that the only activities that operating subsidiaries can engage in are those that are permissible for the parent bank. All of these activities could just as readily be carried on in the parent bank and, if they were, there would be no question at all about the inapplicability of State law or the inapplicability of State law enforcement jurisdiction.

Senator SARBANES. Why do you think they use the operating subsidiaries?

Comptroller HAWKE. There are a whole host of reasons, Senator, why institutions use the operating subsidiary. Sometimes it is an accident of the way the company happened to get into the business. Sometimes they use it for the establishment of different compensation plans within the organization. There are a whole variety of reasons why they do it.

Chairman SHELBY. Thank you. I thank all of you gentlemen. We have another panel here, and I want to thank them for the indulgence. Thank you very much.

Chairman SHELBY. Our second panel will be Mr. Martin Eakes, Chief Executive Officer, Center for Responsible Lending; Mr. Joe Belew, President, Consumer Bankers Association; Mr. Walt McDonald, President, National Association of Realtors®; Mr. William M. Isaac, Chairman, The Secura Group; Mr. Art Wilmarth, Professor of Law, George Washington University Law Center; Mr. James McLaughlin, Director, Regulatory and Trust Affairs, American Bankers Association.

Gentlemen, if you will all take your seats at the table. Your written testimony will be made part of the record of the Banking Committee in its entirety, and I would ask that you briefly sum up your remarks.

Mr. Eakes, we will start with you, if we could. Thank you, sir.

STATEMENT OF MARTIN EAKES CHIEF EXECUTIVE OFFICER CENTER FOR RESPONSIBLE LENDING

Mr. EAKES. Good afternoon. Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for holding this important hearing.

Senator SARBANES. I think if you pull that microphone closer to you, it would be helpful.

Mr. EAKES. I am the CEO of Self-Help, a community development lender based on North Carolina. With $1 billion of assets, we are the largest single nonprofit community development lending organization in the country, which makes us about the size of one Bank of America branch, for perspective.

Self-Help is a lender. We are one of the oldest subprime lenders in the country. In 1984, we started making loans to credit-impaired, minority, single parents. Now, 20 years later, we have provided financing of $3 billion to 37,000 families in 47 States. We have had very few defaults. If a subprime lender has a high number of defaults or foreclosures, they are doing something wrong.

I am also CEO of an organization called the Center for Responsible Lending, a national organization with a staff of 40 lawyers and business analysts that are dedicated to trying to stop predatory lending nationwide. It is nonpartisan, research, legal focused. I and my staff helped craft the North Carolina bill, and we have worked in many of the States that have passed predatory lending bills modeled on the North Carolina bill.

I am not going to say too much about North Carolina unless you ask questions, since my friend, Roy Cooper, was here earlier. What I would like to jump to is to respond to some of the comments that were made in the earlier panel.

The first is the statement by Comptroller Hawke that he has no evidence of national banks being involved in predatory lending. I have to say that for that statement to hold, it means the OCC has to have covered its eyes and closed its ears because it has been hearing a ton from people for at least the last 5 years. Let me give you examples.

The first was Equicredit, which was a subprime lending organization as an operating subsidiary of Barnett Bank. Bank of America, which is one of my favorite banks, we have some of the greatest banks in the world based in North Carolina, and I have worked with every single one of them. Barnett Bank had this subsidiary that turned out to be one of the worst predatory lenders in the country, second only to the Associates First Capital. When Bank of America—Nations Bank at that time—took it over, they inherited this company that had all kinds of problems, had the largest number of foreclosures in Chicago and New York City of any lender. Not once, never, did the OCC intervene to get restitution for—I am not talking about hundreds of borrowers here. I am talking about tens of thousands.

Second, First Union, which owned the Money Story—and, again, to its credit, shut it down, as Bank of America did Equicredit—documented abuses in almost every State where the Money Store operated.

Third, Guaranty National Bank of Tallahassee, as you have heard, was doing thousands of predatory second mortgages and renting its charter to other lenders in North Carolina and other States. The OCC never once provided restitution to any of these borrowers. It took private enforcement and attorneys general. These were all national banks.

First Horizon in New York, which basically decided that it would not cancel a loan even after the loan date, had come and gone. The person had been paying by automatic debit.

Mr. Hawke's statement that, if you tell us, we can, with just a glance, get a resolution I think is really disingenuous. For every set of abuses you have, you only have one out of 200 people who has the savvy and the fortitude to stand up and be the champion to fight an abuse. If you solve it for just that one person and you ignore it for the other 199, you have not solve the problem at all.

Finally, Wells Fargo. I have personally petitioned and provided information. Wells Fargo has become one of the most abusive lenders in the country. The OCC's response to me when I requested a hearing, it reminds me of some of the comments we have just had. I actually got a written response back from the OCC that said, "We have received written comments. We see no reason to have any kind of hearing. The hearing won't add any additional substance."

On that point, I can tell you with 100 percent certainty that they are wrong. Until you have, as I have, met with hundreds if not thousands of people who break down and cry in front of you because they no longer have a home because of these abuses, you do not understand the problem of predatory lending.

What I really want to say is that the OCC is simply not capable of being an honest broker in the area of abusive loans. It is a structural problem. First, they have a financial conflict of interest. We have heard that. Bank of America pays $40 million of fees each year, thereabouts, to the OCC. How easy would it be for the OCC to say we are going to really clamp down on you?

Now, Bank of America is a good bank. They do not have any problems. Let us just stipulate that. But if they did, if they inherited it, how easy would it be to say we are going to cut 10 percent of your budget at the OCC by having this one bank leave? We have had estimates that the top 10 banks represent 30 to 40 percent of the total operating budget of the OCC.

Comptroller Hawke has made personal appeals to AmSouth, banks in Alabama. BB&T has half of the State banking assets for State banks in North Carolina. If they were recruited to become a national bank, the supervision in North Carolina would be significantly hurt.

The second reason that they are structurally unable to work in this arena is that their interest is almost exclusively safety and soundness. It trumps all other concerns. Even in its website and its consumer pamphlets, it states: The OCC does not have a mandate to engage in consumer advocacy, but is responsible for ensuring the safety and soundness of the national banking system.

Number three, the OCC operates in secret. Essentially because they believe that having public debate about a bank's problems could create a safety and soundness problem, they do not believe that anything should be aired. In normal law enforcement, you would think that having public enforcement is very critical to providing deterrence to other bad actors. So unlike HUD, the Treasury, the Federal Reserve, the GSE's, and Congress, the OCC has never held a hearing on predatory lending concerns whatsoever, ever. Even when the Associates was being purchased by Citibank, it was viewed by the advocate community, by the lending community as the most notorious predatory lending acquisition in history, the OCC said, well, we just do not have the authority, even though they are three little banks connected with Associates, we do not have the authority.

Next, when Wells Fargo said we are going to combine all of the 20 different bank charters we have into a single bank, with some newspaper reporting that the reason for that was they did not want to have any privacy concerns if there was information shared among those 20 banks, we requested a hearing of the OCC and we documented the Wells Fargo abusive lending, and the response was, well, we are not going to have a hearing either. Clearly within their power.

My problem is not whether the OCC could have the ability to take on the mantle of consumer protection. Mine is from the real world, down in the trenches with lots of borrowers to tell you that the OCC simply does not have the will or the backbone to stand up and solve these problems.

My fourth reason: The OCC never requires restitution. It is one thing to find a problem after it is already done, after people have already lost their homes. In the mortgage lending arena, with all the publicity of predatory lending that we have had over the years, the OCC, to my knowledge, has one enforcement action ever of 30 borrowers for $1 million in the mortgage lending arena. That is pathetic.

Finally, the fifth reason, the OCC simply does not understand predatory mortgage lending. They just do not understand it. The OCC defines predatory lending as collateral-based, asset-based lending. I have to tell you, that is not the problem. Maybe that is 2 percent of the problem, maybe 3 percent, and that definition would be great if it really was the heart of the matter. But it is not. The problem of program is a focus on individual homeowners and the effort to strip the value of those homes away from them—not to take the home. In fact, it is this hateful case of musical chairs. The lenders want to have as much equity stripped but not be the last lender that actually ends up foreclosing. The actual foreclosing lender will lose $20,000 or $30,000, so no one wants to be that. They want to calculate: Can I be the next to the last lender that strips away the equity?

The OCC, in publishing its rules, had to trash all of the State predatory lending bills, including North Carolina, reflections on New Jersey and others, all of which I have been involved in.

I have been as provocative as I can be over the last 5 years saying that any lender who finds a single borrower who cannot get credit in North Carolina, bring them to me and I will make the loan. Guess how many borrowers I have had presented? I have said it in every forum. I have spoken probably a thousand times on the topic. Never, not a one. They say, well, that is not fair for you to ask. I said, well, that is what was asked of me when we started the North Carolina predatory lending bill. Show me the abuses. Show me that it is not just an anecdotal, case-by-case, one time. And I showed dozens first, and then hundreds, and eventually thousands.

So all I am saying is show me one, give me one. There are none. Our bank commissioner says he gets 1,000 complaints. Not a single complaint from a borrower who could not get a loan. It is just absolute, outright disinformation. And the OCC has played a role in that. They had a working paper which stated, just cavalierly, that all of these laws are eliminating access to credit for poor people. There is no evidence of that. Their working paper never even looked at the fees piece of the problem. They were simply saying, well, the interest rate may correlate with risk. The problem is that up-front fees, back-end prepayment penalty fees, single-premium credit insurance, all these things that are loaded into a loan so that a borrower who does not understand loses their cash value equity.

The example I give is an elderly grandmother who has $50,000 of cash, provides multiple ways for someone to con her out of her $50,000. There are a thousand different ways. But if that same person has $50,000 of equity in a house, there is only one way, and that is to refinance the loan and add fees into the value that essentially eliminate—you want me to wrap it up? Is that what you are saying?

In conclusion, I could talk about the legal issues, but it is really more a moral issue and wisdom issue that I want to present to you. I believe that Congress should intervene to overturn these rules. It will do great harm. In North Carolina, we had the banks come together with the credit unions, which never happens on any topic. And they come together to request a law that would govern all of them, the banks, large and small, State and Federal, credit unions, asking because we want to stop the scourge in our State and the damage to our own reputations, we are willing to have a law that applies to every one of us. When do you remember industry coming in jointly to ask for a law and to have one distant Federal bureaucrat say we are going to wipe that out with the strike of a pen?

I have to tell you, I did not choose to get into this work. I chose to help people build wealth through homeownership. To have him wipe that away is really infuriating to me.

Thank you.

Chairman SHELBY. Mr. Belew.

STATEMENT OF JOE BELEW
PRESIDENT, CONSUMER BANKERS ASSOCIATION

Mr. BELEW. Good afternoon, Mr. Chairman, Members of the Committee, Senator Sarbanes. My name is Joe Belew. I am President of the Consumer Bankers Association, and we very much appreciate the chance to give voice to our views on these issues. I will try to keep my remarks brief.

As I have made clear in my written testimony, the CBA very strongly supports the OCC's recent rulemaking efforts to clarify the extent of its authority over national banks and their operating subsidiaries. These actions are in keeping with the letter and the spirit of the National Bank Act as interpreted by over a century of court opinions. They were only finalized after an extensive notice and comment period that generated over 2,600 comments.

The proposals were issued against a backdrop of stringent OCC examinations and a broad sweep of consumer protection, as well as safety and soundness laws. We call the Committee's attention to the list we have provided of all these Federal statutes. They cover virtually every imaginable area of consumer protection.

OCC enforcement is effective, in our view, because the agency employs nearly 1,700 examiners to ensure compliance and safe and sound operations. Many CBA members house some of the 300 or so on-site examiners who are engaged in continuous—24/7 almost—supervision of the largest banks.

Furthermore, the OCC has been forceful in enforcement of these laws, when necessary. The Agency wants national banks to remain the gold standard in their dealings with the public and to take swift action in the rare instances when it discovers wrongdoing. This tough approach by the OCC is not new. For instance, as far back as June 2000, OCC Counsel Julie Williams put the industry on notice at a CBA conference that the Agency would use all its powers to anticipate and address any predatory lending concerns, one reason such problems do not usually show up in national banks. Another reason is that our members, predominantly national banks, are also going well beyond the requirements of the law to promote financial literacy programs that will help shield consumers, and these help customers of other institutions and other companies.

For the fourth year, we are surveying our member banks to determine the extent of their involvement in financial literacy efforts as a measure of their sense of responsibility to the communities and the markets they serve. The last survey showed that 98 percent of our respondents sponsor financial literacy programs or partner with others on financial education initiatives. The preliminary results of the current survey show that the involvement of banks in the financial education of homebuyers, students, the elderly, and small business continues. We will be pleased to share the results when they appear.

Financial literacy efforts are important, but they are not enough. It is widely acknowledged that national banks are not the main point of the problem. The OCC still is vigilant in its oversight. The old expression holds true: "An ounce of prevention is worth a pound of cure." And that is why the Agency's extensive examination and oversight, coupled with swift enforcement when needed, lead us to support the OCC's rules as sound public policy.

I must say, departing from my text, that the bankers that I talk to do not share a view that the OCC is somehow lax and asleep at the wheel.

To be sure, there is another reason for our support, to be candid, and that is, the banks' need for predictability and uniformity across their operations. CBA's members, generally the country's larger financial institutions, typically operate in multiple States. Some are in over half the States of the Union. Many operate literally thousands of branches and have millions of customers, many of whom relocate and maintain their old principal banking relationship in their new State.

Increasingly, in recent years, national banks have been facing the intrusion of State and local laws on their federally created powers. These actions created the need for greater clarity and predictability for the banks and their subs operating in multiple jurisdictions nationwide under the uniform guidance of the OCC. And these regulations help provide that guidance and that clarity.

In summary, we support the OCC rules as being firmly grounded in historical precedent and Congressional law, and we welcome the clarity they provide for national bank operations.

We thank you again for the opportunity to be with you.

Chairman SHELBY. Mr. McDonald.

STATEMENT OF WALTER T. McDONALD
PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

Mr. MCDONALD. Chairman Shelby, Senator Sarbanes and, Members of the Committee, thank you very much for holding this hearing and for inviting us here today to share the views of the National Association of Realtors. My name is Walt McDonald, and I am broker-owner of Walt McDonald Real Estate, a single-office, independent firm in Riverside, California, specializing in property sales, leasing, and lending. I have been a Realtor for 40 years, and as President of the National Association of Realtors, I represent over 1 million Realtors—Realtors who are involved in all aspects of the residential and commercial real estate industry.

NAR's members operate real estate brokerage, leasing, management companies, and many own affiliated businesses such as title agencies and mortgage lending companies. NAR members represent roughly 80 percent of consumers who buy and sell homes in America.

Let me be clear at the outset. The OCC preemption rule favors big business at the expense of the American consumer. It is bad for consumers, it is bad for small business, and it is bad for Realtors.

But do not take just our word for it. There are many others—and you have heard from a lot of them today—who oppose this rule and the improper overstepping of the OCC, including all 50 State attorneys general, all 50 State banking supervisors, all 50 Governors, the National Conference of State Legislators, State real estate commissioners, AARP, Consumer Federation of America, to name just a few.

This rule is the latest in a series of Federal regulators' decisions that give special treatment to big corporations without considering the potential negative impact on consumers. The rule is helping to create an industry that is dominated by a few large mega-banks, leaving consumers with fewer choices and higher fees. And it sends a clear message to consumers that the Federal Government cares more about corporate America than about American consumers.

What is more, this rule and its tremendous potential impact has been made without input from Congress. NAR believes that policy decisions having such a profound effect on a whole industry, on States rights, and on consumers should only be made by elected officials in Congress, and that is why we are here today urging the Members of this Committee and the entire Congress to reassert its authority in this area and to rein in the regulatory authorities and to repeal the action of the OCC.

As recently as last week at the House Financial Services Committee oversight hearing on the OCC, Comptroller Hawke insisted that real estate brokerage is not affected by this rule. While its response is consistent with the correspondence between OCC and NAR's offices, it fails to recognize the immediate anticompetitive effect that this rule has on our members who own affiliated lending operations.

Realtors will continue to be subject to all State laws, licensing, and registration requirements. These rules protect consumers, and they are good for our business, and we are happy to comply with them. Unfortunately, though, under the OCC preemption rule, national banks and their operating subsidiaries no longer will need to abide by these same rules and these same laws. It is simply not fair that the local mortgage company will be required to pay various fees to the State and comply with numerous State regulations, while the local branch for the mega-bank next door will be exempt from those same rules and laws.

At a time when the mega-banks are becoming even larger and more profitable, why does the OCC think that it is necessary to remove State oversight and State regulation? State laws, regulations, and consumer protections have not kept big banks from enjoying the largest profit margin that they have earned in decades. If the current regulatory system is not broken, why does the OCC need to fix it?

Moreover, this rule has other potential negative consequences for both consumers and the real estate industry. Before February 12, mortgage brokers in my home State of California had to be licensed. Now if they work for a national bank or its operating subsidiary, mortgage brokers will not need that license. But there is no comparable Federal mortgage broker license or regulation, and neither the State law enforcement nor real estate officials can investigate or regulate those mortgage brokers.

NAR is disappointed that Comptroller Hawke once again is unwilling to acknowledge that his new rule clearly and unmistakably declares that any State law that obstructs, impairs, or conditions a national bank's ability to fully exercise its powers to conduct active business is preempted. The impact of the new rule goes well beyond the type of laws that are listed in this rule. The Comptroller's rule gives national banks wide latitude to simply ignore any State law that they conclude conditions their activities.

It is difficult to imagine any State law that would not in some way condition banking. It is this open-ended nature of the rule that gives Realtors so much concern. Perhaps—and I think the question was asked earlier, but perhaps this Committee can point to the condition language of the rule and ask the question of Mr. Hawke as to his view of the breadth of that term of the language. No one else has been able to gain any specific definition from OCC.

NAR is concerned that the Comptroller's new rule is yet another link in the chain that will lead to national banks engaging in activities beyond their current activities, such as real estate brokerage, while remaining unconstrained by State consumer protection safeguards and licensing requirements. It is clear to NAR that the expansion of national bank activities at the expense of State consumer protections is bad for consumers, it is bad for the community-based businesses that serve them best, and NAR is firmly committed to ensuring that Congress carefully scrutinizes the implications of the Comptroller's actions and takes the appropriate legislative action to ensure that only Congress make such profound policy decisions.

I thank you again for the opportunity to be here today, and I look forward to any questions you might have.

Chairman SHELBY. Mr. Isaac.

STATEMENT OF WILLIAM M. ISAAC
CHAIRMAN, THE SECURA GROUP

Mr. ISAAC. Thank you, Mr. Chairman, Members of the Committee. It is my pleasure to be here. I am Bill Isaac, Chairman of the Secura Group, and prior to founding Secura in 1986, I served for 8 years on the Board of the FDIC, including 5 years as Chairman during the banking crisis of the 1980's. My entire career has been spent in the financial services industry in one capacity or another, including a number of years as an attorney specializing in banking law.

I must say I am confused by the uproar over the Comptroller's regulations because the Comptroller says that he is attempting to codify, not change existing law, and I could not agree more. When I went into the banking law practice in 1969, that was the law of the land. I was representing national banks and State banks, and everyone understood that national banks were governed by the Comptroller of the Currency with respect to their activities, their deposit and loan-taking activities, and that the States had no authority over them. And then I became general counsel of a bank, and I still understood that. And then I became Chairman of the FDIC and I still understood that. And so I do not understand how anybody thinks that the Comptroller of the Currency has done anything to change existing law. He simply is putting it down in one easy place for everybody to see and make their judgments about it. If he is acting illegally, I presume the courts will overturn him. But

I do not think we would be having these hearings today if the attorneys general really thought that he was going to get overturned. I think they believe that what he the Comptroller has done is perfectly legal under existing law. They do not like existing law, and they would like the Congress to change it. And so that is why we are having these hearings.

The Conference of State Bank Supervisors and the attorneys general have been claiming that the Comptroller is forging new ground and, if his actions are upheld, it is going to undermine the dual or State-Federal, banking system and will injure consumers. My personal view is that nothing could be further from the truth. I believe the Comptroller's preemption regulations are proconsumer. They are very much in the interest of all banks, State and national chartered. The Comptroller's rules are essential to the preservation of our dual banking system because if the States are allowed to regulate national banks, we will not have a national banking system anymore.

The Comptroller's rules are fully in accord with 140 years of statutory and case law, including decisions by the U.S. Supreme Court, and are quite similar to the Federal preemption rules governing federally chartered thrift and credit unions, which do not seem to be in dispute at all. I am not sure why we are singling out banks and not talking about credit unions and thrifts, if we are going to talk about this issue.

The larger national banks do business throughout the Nation, and they cannot operate effectively and efficiently if they must tailor their products to the laws of 50 States and who knows how many local jurisdictions. As I have sat through the hearing today I have noticed that this issue is not discussed at all. How are these banks going to operate if they have to comply with every law that every city council decides they want to impose on a bank?

We had an example a few years ago in Santa Monica, when Santa Monica's City Council decided to regulate ATM fees different than anybody else in California or the Nation was doing. The large banks said to their customers in Santa Monica, "you cannot do business in our ATM machines until this gets straightened out." I do not believe this was a proconsumer move on the part of Santa Monica. Ultimately, the courts overturned the Santa Monica City Council and said it could not interfere with the national banks' ATM charges.

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

The contention of the various State attorneys general and bank commissioners that they are more effective than the Comptroller of the Currency in enforcing their laws, their consumer protection measures, strains credulity. The Comptroller has nearly 2,000 supervisory personnel dealing with national banks each day. Those personnel have enormous legal authority and even greater moral suasion with respect to national banks. While an attorney general is huffing and puffing and threatening to go to court against a bank without much effect, all it takes is a frown from the Comptroller of the Currency to bring a national bank into line. This is particularly true of the larger banks, which simply have no choice but to be on the good side of the Comptroller's office.

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

I want to make one last point, because I am a little bit over my time. Many if not most of the State banking departments, when I was Chairman of the FDIC, were chronically short of financial and personnel resources and relied heavily on the FDIC to assist in the supervision of their banks and in the training of their personnel. To my knowledge, they still rely on the FDIC heavily for both.

I find it somewhat difficult to imagine how or where the State banking departments could possibly find the resources to take on the additional duties of overseeing national banks within their borders. Indeed, the chart shown in my written testimony reveals that the Comptroller of the Currency has nearly one examiner for every bank under its supervision, while the State banking departments have one examiner for every 48 institutions under their supervision. It is kind of like the dog chasing the car. I do not know what they are going to do when they catch it. I hope they do not.

Thank you.

Chairman SHELBY. Mr. Wilmarth.

STATEMENT OF ARTHUR E. WILMARTH, JR.
PROFESSOR OF LAW
GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Mr. WILMARTH. Thank you, Chairman Shelby, Senator Sarbanes, and Members of the Committee. I appreciate this opportunity to appear before you to discuss my concerns regarding these two regulations that the OCC has issued. The scope of the OCC's regulations is really not in dispute. As Comptroller Hawke has said, the new preemption regulations effectively bar the application of all State laws to national banks except in areas where Congress has incorporated State-law standards into a Federal statute or where the OCC deems that State laws have only a "incidental" effect on national banks. In describing what the term "incidental" means, the OCC has said that a State law is incidental only if it is part of the "legal infrastructure" that makes it practicable for national banks to conduct their federally authorized activities. According to the OCC, a State law may not regulate the manner or content of the business of banking authorized for national banks.

So, in other words, State laws apply to national banks only if the OCC finds that they promote the ability of national banks to do business. And, of course, as you have heard, the OCC's preemption rule applies not only to national banks themselves, but also to their State-chartered operating subsidiaries.

Comptroller Hawke has also said that the OCC's preemption and visitorial powers rules are deliberately designed to provide the same field preemption regime to national banks that the OTS has established for Federal savings associations and their operating subsidiaries.

The OCC's new regulation on visitorial powers prohibits any attempt by State officials to sue in Federal or State courts to compel national banks or their operating subsidiaries to comply with State laws. As further explained in OCC Advisory Letter 2002–9, the OCC exercises sole and unfettered discretion to decide whether any particular State law is applicable to a national bank, and even if it is applicable, whether that law should be enforced. The States have no role to play beyond simply providing a referral of information to the OCC.

Unless the OCC's new rules are overturned by Congress or the courts, I believe the rules will destroy the competitive balance between State and national banks that Congress has long maintained within the dual banking system. The dual banking system simply cannot survive unless there is a basic parity of competitive opportunities between State and national banks.

In addition, the OCC rules regarding operating subsidiaries will seriously impair the States' authority to regulate State-chartered corporations and also to protect consumers from illegal, fraudulent, and unfair financial practices.

There are several reasons why, in my opinion, the OCC does not have authority to adopt its new rules.

First, the OCC's attempt to create a regime of de facto field preemption is contrary, in my view, to a long line of decisions issued by the U.S. Supreme Court. For example, the U.S. Supreme Court said in *Atherton* v. *FDIC,* in 1997, that "federally chartered banks are subject to State law." And as you have heard, the 1996 Supreme Court's decision in Barnett Bank said that State laws apply to national banks unless they "prevent or significantly interfere with" the ability of national banks to exercise their Congressionally authorized powers. Congress specifically endorsed the Barrett Bank particular standard as part of the Gramm-Leach-Bliley Act.

I would also like to refer to the decision of *National Bank* v. *Commonwealth* in 1870, which is referred to in both Atherton and Barnett. In that case, the Supreme Court expressly distinguished *McCulloch* v. *Maryland,* which the Comptroller is fond of quoting. In McCulloch, the Supreme Court found that a particular State tax was being used to destroy the Second Bank of the United States. In Commonwealth, the Supreme Court said that where that is not the case, where the State is not trying to destroy a national bank, then 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."

I would also like to refer to the case of *Osborn* v. *Bank of United States,* an opinion written by Chief Justice John Marshall, in which he elaborated on his earlier opinion McCulloch. In Osborn, Chief Justice Marshall explained that it was very important to understand that the Second Bank of the United States was the fiscal agent of the U.S. Government. It was, in practical effect, the central bank and was undertaking important public functions for the Federal Government.

Chairman SHELBY. You are referring to *McCulloch* v. *Maryland?*

Mr. WILMARTH. I am discussing *Osborn* v. *Bank of United States,* which was the next case.

Chairman SHELBY. Okay.

Mr. WILMARTH. In Osborn, Chief Justice Marshall was trying to defend what he had done in McCulloch. And he said that if the Second Bank of the United States was carrying on the "mere business of banking," a merely private business, then that business could be lawfully taxed, regulated, or restrained by the States, even if it was carried on within a Federal corporation. The Second Bank's Federal charter did not provide an immunity from State laws. What gave the Bank its immunity was the fact that it was carrying on important public functions.

Today's national banks are not fiscal agents of the U.S. Government. They do not issue currency. They are not the funding device they used to be when they bought bonds of the Federal Government and issued currency based on those bonds. The Federal Reserve Act of 1913 gave all those functions to the Federal Reserve Board and the Federal Reserve System.

As the dissenting opinion pointed out in the First Agricultural National Bank case in 1968—and the majority opinion did not disagree—today's national banks are entirely private entities carrying on a private business. So, under Chief Justice Marshall's analysis in *Osborn* v. *Bank of United States,* they do not have any blanket immunity from State regulation. They do have an immunity when State laws directly conflict powers that with you, Congress, have granted to them. But the OCC's news rules go far beyond that. To paraphrase Comptroller Hawke, he has said that unless you, the Congress, declare that State laws apply to national banks, the OCC will preempt all State laws that impose any condition or impediment on national banks. That simply is not the standard that the Supreme Court has articulated in the cases I have discussed, nor is it the standard that Congress adopted in the Riegle-Neal Act of 1994 or in the Gramm-Leach-Bliley Act of 1999.

Perhaps if questions permit, I would like to indicate further reasons why I believe that the OCC simply did not have authority to adopt these rules. To conclude, in cases like *New York* v. *FERC,* 535 U.S. 1, at page 18, and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, at pages 213 and 214, the Supreme Court declared that a Federal agency has no power to make law. It has only the power to carry into effect the authority granted to it by Congress. And an agency has no power to preempt State law on its own.

Chairman SHELBY. You believe this is an overreach, do you not?

Mr. WILMARTH. Yes, in my humble opinion, it is by far an overreach. And I think that is why you are seeing the extent of opposition and controversy surrounding the OCC's rules. If it were indeed not a matter of great controversy. I do not think we would all be here today.

Thank you very much. I appreciate the opportunity to appear before your Committee.

Chairman SHELBY. Thank you, sir.

Mr. McLaughlin.

STATEMENT OF JAMES D. McLAUGHLIN
DIRECTOR, REGULATORY AND TRUST AFFAIRS
AMERICAN BANKERS ASSOCIATION

Mr. McLAUGHLIN. Thank you, Mr. Chairman, Members of the Committee. I am Jim McLaughlin from the American Bankers Association. We appreciate your holding this hearing.

ABA strongly supports this rule. I would like to summarize three key points from my written statement.

First, in creating a national banking system, Congress explicitly gave to the OCC exclusive powers to regulate national banks. Congress also gave the Comptroller the authority to preempt State and local laws that would conflict with those powers. It was 140 years ago that Congress clearly gave the OCC the authority that is used in this rule, and previous Comptrollers have used that power in many instances over the 140 years.

Furthermore, court after court, including the Supreme Court many times—and I will engage my associate in that debate if you would like—has upheld that authority as shown in the list of cases attached to my testimony.

Despite the controversy, to a very large degree the OCC rule does not break new ground. The areas covered in the rule have, in many cases, already been subject to preemption by the OCC. In the past, these preemptive rules went forward generally on a case-by-case basis. That approach worked when the State and local actions that were preempted occurred infrequently. But recently we have seen a proliferation of State and local actions. Several have ended upon the courts where preemption was upheld.

That leads to my second point. This rule is needed to make it clear to all parties where the line on preemption is. While most legal experts in this arena know that State and local laws that impinge on the fundamental activities of national banks are preempted, State and local officials have often proceeded despite the virtual certainty that their efforts will be struck down by the courts. In the meantime, national banks face costly uncertainty as to how to proceed with the business. Banks, the OCC, and taxpayers of those State and local governments end up wasting considerable resources in litigation. This OCC rule will help to avoid that uncertainty and litigation cost by bringing together in one place what was, in fact, occurring on a case-by-case basis.

Third, we are concerned that what many of the opponents of this rule are advocating would render the dual banking system virtually meaningless. The areas addressed by the OCC rule—lending and deposit-taking—are fundamental to the business of banking. If State and local governments can regulate these most basic activities of national banks and if States can examine national banks, what is left of the national system?

Finally, much of the debate over this rule has been in the context of the need to address the terrible problem of predatory lending. There are two approaches to predatory lending that we believe would work well without undermining the dual banking system. The first involves cooperation between the OCC and State and local officials. The OCC has indicated its strong interest in this kind of cooperation.

A second approach, which is not inconsistent with the first, is the passage of targeted Federal legislation to address predatory lending. There are a number of areas where Congress has determined that a Federal approach to a given consumer protection issue is warranted. As you know, this is the approach recently taken by Congress with respect to the Fair Credit Reporting Act. We would be happy to work with your Committee, Mr. Chairman, should you choose to consider a national approach to predatory lending.

Finally, if I may, Mr. Chairman, I would like to add a footnote to my statement. I was very pleased to see the representative from the National Association of Realtors here at the panel acknowledge that real estate brokers are, in fact, competing in financial services with national banks. He mentioned their mortgage affiliates. He mentioned their title insurance and other insurance affiliates. We welcome their competition. But I think that is a subject for another hearing.

[Laughter.]

Chairman SHELBY. To Mr. Eakes, if the OCC had not come forward with these rules, what negative consequences would there have been for national banks and their customers in their absence?

Mr. EAKES. Sorry, say it again? If they had not come forward, I do not think there would be any.

Chairman SHELBY. None?

Mr. EAKES. Uniformity of rules is highly overrated.

Chairman SHELBY. Mr. Belew.

Mr. BELEW. Let me address his last point. Uniformity of rules is not highly overrated. With the numbers of customers, as I pointed out, and banks operating subject to at least 20 or 25 State laws, there is quite a lot to be said for national uniformity among banks, thrifts, and credit unions.

Now, I may not have answered the first part of your question.

Chairman SHELBY. You did all right.

Mr. BELEW. Thank you.

Chairman SHELBY. Well, I will just ask you: In other words, if the Comptroller had not come forth with these rules, what would have happened?

Mr. BELEW. Frankly, I think it would have left the landscape open for vast numbers of class action suits and litigation. More to the point, it leaves both consumers and the financial industry at a loss as to what the rules really are, and we want one set of rules.

Chairman SHELBY. What impact will the new rules have on the development and the enforcement of consumer protection standards, Mr. Eakes?

Mr. EAKES. Well, my point on uniformity is that democracy is messy, so is Federalism. If you do not have the experimentation in eastern North Carolina dealing with mobile homes to figure out how do you solve that problem, and you just cut it off and say we are going to have one standard that is a very weak standard, the problem is that we will never address and solve the problem that we all abhor.

Chairman SHELBY. Mr. McLaughlin, do you want to reply to that? In other words, what impact will the new rules that the Comptroller has brought forth have on the development and the enforcement of consumer protection standards? It would preempt a lot of the States, would it not?

Mr. MCLAUGHLIN. It would preempt some of the State laws, but at the same time, we have seen consumer protecting initiatives come from the OCC. This is part and parcel of the dual banking system. The States charter, the States regulate and oversee State-chartered banks. The Federal Government charters, regulates, and oversees national banks. And if you, as the Congress overseeing the OCC, think that the OCC should do a better job enforcing consumer protection laws, you have that power. Similarly, each State legislature has that authority over the State banking department.

Chairman SHELBY. Professor Wilmarth, I asked the previous panel about the appropriate place to draw the preemption line. In other words, where do you think the line needs to be drawn? How do we do it?

Mr. WILMARTH. Well, I think the Barnett Bank decision tried to give us guidance by saying that, yes, the States may not prevent or significantly interfere with what you, the Congress, have authorized for national banks. Certainly the courts have found it possible to apply that standard and to say: Is this a State condition that is properly designed to meet a legitimate State interest and does not represent a significant impairment or impediment to the national banks' ability to conduct their federally authorized business? Or is this a very onerous State restriction that greatly hampers the ability of a national bank to exercise a particular power?

In Barnett Bank, the State of Florida was trying to prohibit the exercise of an express national bank power. In the case of *Franklin National Bank* v. *New York,* the State of New York tried to say that a national bank could not advertise for savings deposits, could not let it be known to the public that it was offering savings deposits. That was obviously a significant impairment on the ability of national banks to do business. But the OCC's view is that any State condition, any impediment of any nature will be preempted, which just sweeps the field clean.

So my own view is that the Barnett Bank standard establishes the proper guidlines, standard, and there was no need for the OCC to go beyond that standard. By going beyond Barnett Bank, particularly in the visitorial powers area, and by saying that we are now going to prevent the State from bringing action in court to enforce the law, even against an operating subsidiary, the OCC is trying to prevent the kind of State enforcement that has proven to be very effective and very necessary in the securities scandals, in the mutual fund scandals, in some of the privacy violations. That State enforcement simply won't occur anymore.

Chairman SHELBY. Are you saying there will not be a remedy?

Mr. WILMARTH. Right. There will be no remedy. Essentially, as Attorney General Cooper said, the OCC is taking a whole set of additional law enforcement authorities off the beat. We have seen in other areas of this evolving, very complex financial services marketplace, that uniform Federal regulation is not able to catch all of the abuses that are occurring.

Chairman SHELBY. On a long-term basis, what is your view as to the impact of the rules on the operation of the dual banking system, Professor?

Mr. WILMARTH. Well, as I say in my written statement and in a forthcoming article, the impact will be very severe. The decision of HSBC to convert to a national bank charter has already been mentioned. Another very significant development is the decision by JP Morgan Chase to take all 300 of their consumer lending offices outside the New York City metro area and put them into a Federal savings bank charter. And they said in their press release: "We are doing this because of preemption." That was one of the big factors behind their decision.

So, I think there is no doubt that if the OCC's preemption standard stands, is not changed, within the next——

Chairman SHELBY. It will be a big attraction, won't it?

Mr. WILMARTH. Within the next 5 to 10 years, I think there won't be a single large multi-State bank that will be operating under a State charter. And then the question becomes: Can the States sustain any kind of meaningful banking system with only community banks? At the same time, banks will no longer have any effective choice of charter. There will not be much incentive for innovation or flexibility among bank regulators. I actually think that the large banks may well regret what they are now pursuing when they get a regulator for which basically there is no exit, there is no option. The dual banking system has made our economy unique, has meant that all areas of our great country have been developed. If you look north into Canada where they have had a uniform Federal system with comprehensive Federal preemption, many people will tell you that the banks up there are not involved in community development in the same way that they are down here. And you do not have nearly as many banks being involved either.

Chairman SHELBY. Gentlemen, I appreciate your patience today. It has been a long afternoon. The first panel took a lot of time. This is an important hearing, and we appreciate your participation. Thank you very much.

The hearing is adjourned.

[Whereupon, at 5:18 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

For Release Upon Delivery
2 p.m., April 7, 2004

TESTIMONY OF

JOHN D. HAWKE, JR.

COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Of the

U.S. SENATE

April 7, 2004

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, I appreciate this opportunity to address the OCC's recent rulemakings pertaining to the applicability of State laws to national banks. Federal preemption of State law is a subject that touches on fundamental characteristics of the national bank charter, fundamental responsibilities of the OCC, the essential attributes of this country's dual banking system, and how the interests of customers are served by the national banking system and protected by the OCC.

I welcome the opportunity to explain how our rules further the longstanding purposes of the national banking laws to ensure that national banks operate pursuant to a uniform set of nationwide standards; how they reinforce and reaffirm the high standards of integrity and fair treatment of customers that we expect of national banks; and how they preserve the distinct roles of Federal and State regulators that define our dual banking system. I should emphasize that these rules resulted from a process the OCC began in 2002, by discussing with consumer groups, members of Congress and their staffs, and industry groups, the need for regulations to codify well-established preemption precedents and clarify the regulations implementing the statute governing the OCC's exclusive visitorial powers. The actions that we ultimately determined to take are grounded in the existing law, are not dramatic departures from existing preemption precedents and principles recognized for Federally chartered institutions, and were taken in accordance with established, formal rulemaking processes.

In reviewing these rules, particularly as they affect State anti-predatory lending laws, it is important not to lose sight of three fundamental points:

- National banks are highly regulated and closely supervised. There is no evidence that they are the source of predatory lending practices.
- The OCC is committed to protecting customers of national banks; where problems have arisen, our track record shows that we will act to fix them.
- We welcome opportunities to enhance information sharing and collaboration with the States to address customer complaints and consumer protection issues.

My written statement, which addresses these points in greater detail, covers four areas. I will begin by describing briefly what our new rules do, and, in order to address some confusion that exists, what they do *not* do. Second, I will describe the actions the OCC has taken to ensure that customers of national banks are not subject to unfair, deceptive, abusive or predatory practices. Next, I will explain the reasons why we issued these new regulations. Finally, my testimony will address the principal arguments that have been advanced by those who question these new rules.

II. The OCC's Regulations

In January of this year, the OCC issued two final rules that address the applicability of State law to national banks. The first regulation, which follows the approach taken by the Office of Thrift Supervision (OTS) in its preemption regulations for Federal savings associations, clarifies the extent to which the operations of national banks are subject to certain State laws by codifying the principles announced in a number of judicial decisions and OCC interpretations, as well as in OTS regulations (the preemption rule). The second rule amended aspects of the OCC's existing regulation concerning the OCC's exclusive "visitorial powers" with respect to national banks (the visitorial powers rule).

Increasingly in recent years, States – and even cities and counties – have enacted laws that attempt to constrain powers national banks are authorized to exercise under Federal law. In addition to conflicting with Federal authorities, these efforts have resulted in greater uncertainty about the standards applicable to national banks' operations, costly litigation to resolve that uncertainty, and in some respects, constriction of the availability of legitimate credit. One purpose of our regulations is to provide the clear guidance needed to ensure that national banks operate under uniform, predictable Federal standards. A second – and equally important – goal was to ensure that the Federal standards under which national banks operate directly address and prevent abusive or predatory lending practices. I next describe each rule in turn.

The Preemption Rule

The preemption rule adds provisions to our regulations expressly addressing the applicability of certain types of State laws to national banks' lending and deposit-taking activities. With regard to these activities, the preemption rule states the general principle that, except where made applicable by Federal law, State laws do not apply to national banks if they "obstruct, impair, or condition" the bank's exercise of powers granted under Federal law. The rules' preamble makes very clear that these words are not designed to create a new standard of preemption, but rather to distill the various phrases the Supreme Court has used in its preemption decisions.[1] In the lending and deposit-taking areas, the preemption rule then lists certain types of State laws that are preempted by Federal law and therefore are not applicable to national banks. In other words, the rule preempts the types of laws listed in the rule; other types of laws remain subject to case-by-case evaluation under established judicial standards.

For lending, examples of preempted laws include laws that restrict or prescribe the terms of credit, amortization schedules, permissible security property, escrow accounts, disclosure and advertising, and laws that require a State license as a condition of national banks' ability to make loans. For deposit-taking (in addition to laws dealing with disclosure requirements and licensing and registration requirements), the laws listed include laws that address abandoned and dormant accounts, checking accounts, and funds availability. In both areas, the listed types of laws either are preempted under longstanding, pre-existing OCC regulations, have been addressed in OCC preemption opinions, have been found to be preempted by the courts, or have been determined to be preempted by the OTS with respect to Federal thrifts. Thus, they are the types of laws for which substantial precedent exists recognizing the interference they pose to the ability of Federally chartered institutions to operate under uniform Federal standards.

The preemption rule also contains two new provisions that expressly prohibit abusive or predatory lending practices. First, the rule prohibits national banks from making any consumer loan based predominantly on the foreclosure or liquidation value of a borrower's collateral, rather than on the borrower's ability to repay the loan according to its terms. This anti-predatory lending standard applies uniformly to all consumer lending activities of national banks,

[1] 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004).

regardless of the location from which the bank conducts those activities or where its customers live. This standard strikes at the heart of predatory lending, namely lending practices that effectively swindle a homeowner out of his or her property.

Second, the preemption rule provides that, in connection with *any* type of lending, national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act (FTC Act), which prohibits "unfair or deceptive acts or practices" in interstate commerce. We added an express reference to Section 5 to our rule in response to commenters who urged us to affirm that this Federal standard applies to national banks. We viewed this addition as particularly appropriate in light of the fact that the OCC pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct.

It is important to emphasize that these new standards are comprehensive and they apply nationwide, to all national banks. The rules apply strong protections for national bank customers in every State – including the majority of States that do not have their own anti-predatory lending standards.

It also is important to emphasize several things that the preemption rule does *not* do. The final rule *does not* immunize national banks from all State laws, and it does *not preempt* undiscriminating laws of general applicability that form the legal infrastructure for conducting a banking or other business. Examples of laws that are not preempted are also identified in the preemption rule and include State laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts. The rule also does not disturb the status quo concerning preemption of State escheat and unclaimed property laws; rather, it reaffirms that preemption does not occur for those types of laws that the Supreme Court has found not to be preempted.[2] In addition, any other law that only incidentally affects national banks' exercise of their Federally authorized powers to lend, take deposits, and engage in other Federally authorized activities would not be preempted under the final rule. This distinction is solidly founded in decisions of the U.S. Supreme Court.

The rule *does not preempt anti-discrimination laws.* There appears to have been some misunderstanding on this point, perhaps because some State predatory lending laws that actually seek to regulate loan terms have "fair lending" in their titles.[3] The preemption rule, consistent with Federal judicial precedents,[4] does not preempt laws prohibiting discrimination in lending.

The rule *has absolutely no effect on real estate brokerage.* The rule neither enhances the ability of national banks to engage in real estate brokerage nor preempts State laws pertaining to real estate brokerage. National banks and their operating subsidiaries are not authorized to engage in the real estate brokerage business. The rule addresses certain types of State laws concerning real estate *lending*, not brokerage. Suggestions that the rule affects real estate brokerage activities are based on speculation about a combination of circumstances neither of which exists: (1)

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[2] *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944).

[3] *See, e.g.*, the Georgia Fair Lending Act, GA Code. Ann. §§ 7-6A-1 *et seq.*, which does not address lending discrimination.

[4] *See, e.g., National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980) (New Jersey anti-redlining statute applicable to national banks); *see also Peatros v. Bank of America NT&SA et al.*, 22 Cal 4th 147 (2000) (where Federal law otherwise provides in employment discrimination context, State anti-discrimination statute not necessarily preempted).

authorization of national banks and their operating subsidiaries to conduct real estate brokerage (they are not so authorized); and (2) an OCC rule preempting State real estate broker laws (there is no such rule).[5]

In fact, the preemption rule *does not authorize any new national bank activities or powers.* The rule does not address or affect activities authorized for financial subsidiaries. Nor does it impinge on the functional regulation framework for insurance and securities regulation established by Congress in the Gramm-Leach-Bliley Act.

Finally, the preemption rule makes no changes to the OCC's rules governing the activities of operating subsidiaries. The OCC already has rules on the books imposing the same terms and conditions on national banks' activities whether they are conducted directly or through an operating subsidiary, except where Federal law or regulation otherwise provide. By virtue of these pre-existing regulations,[6] the preemption rule has the same effect on national bank operating subsidiaries as it has on national banks.

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[5] Concerns about preemption of State real estate brokerage laws appear to be prompted not by the regulation the OCC has issued, but by the possibility that national banks could, in the future, be permitted to engage in real estate brokerage activities. Several years ago, the Board of Governors of the Federal Reserve System (Board) and the Department of the Treasury (Treasury) issued a proposal addressing whether real estate brokerage should be considered an activity that is "financial in nature," and thus permissible for financial holding companies and bank *financial subsidiaries*. *See* 66 Fed. Reg. 307 (January 3, 2001). The OCC's preemption rule would not apply to real estate brokerage activities even if the joint proposal were ever to be finalized. The rule does not apply to national bank financial subsidiaries. Thus its provisions do not preempt *any* State laws – including State real estate brokerage laws – for financial subsidiaries. Moreover, the preemption rule could not apply even if the Board-Treasury proposal were finalized because the applicability of State law to financial subsidiaries is determined under a different standard, that is, the standard that Congress expressly established in Section 104 of the Gramm-Leach-Bliley Act. 12 U.S.C. § 6701(d)(1).

[6] *See* 12 C.F.R. §§ 5.34 (operating subsidiaries subject to same "terms and conditions" as apply to the parent bank) and 7.4006 (applicability of State law to national banks). *See also id.* at § 34.1(b) (real estate lending rule applies to national bank operating subsidiaries).

The Visitorial Powers Rule

"Visitorial powers" is a term used to refer to the authority to examine, supervise, and regulate the affairs of a corporate entity. Under the National Bank Act, the OCC has exclusive visitorial powers over national banks. Specifically, 12 U.S.C. § 484 provides that "no national bank shall be subject to any visitorial powers except as authorized by federal law, vested in the courts of justice" or exercised by Congress or a committee of Congress.[7] This provision dates from the earliest days of the national banking system and is integral to the overall scheme of the national banking system and the ability of national banks to conduct the business of banking subject to uniform, consistent standards and supervision, wherever in the nation they operate.

Existing OCC regulations implement the visitorial powers statute by providing that State officials are not authorized to inspect, examine, or regulate national banks, except where another Federal law authorizes them to do so.[8] The amendment to the visitorial powers rule clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national bank activities authorized under Federal law.[9] In other words, the OCC is the exclusive supervisor of a national bank's banking activities. The rule *does not prevent* State officials from

[7] 12 U.S.C. § 484.

[8] 12 C.F.R. § 7.4000.

[9] 69 Fed. Reg. 1895 (Jan. 13, 2004).

enforcing State laws that do not pertain to a national bank's banking activities, such as health and safety standards or criminal laws of general applicability. [10]

Another amendment to the existing rule also clarifies that the *preservation* of visitorial powers "vested in the courts of justice" does not *grant* State officials new authority, in addition to whatever they may otherwise have, to use the court system to exercise visitorial powers over national banks. State Attorneys General do not dispute that Federal law prevents them from examining or taking actions directly against national banks, such as through cease and desist proceedings. What our revised rule says is that they may not use the courts to accomplish indirectly what they acknowledge the Federal statute prohibits them from accomplishing directly.[11] The visitorial powers rule *does not* preclude States from seeking a declaratory judgment from a court as to whether a particular State law applies to the Federally authorized business of a national bank.

Finally, like the preemption rule, the amendments to the visitorial powers rule make no change to the treatment of operating subsidiaries. Thus, in accordance with previously adopted OCC regulations, States generally can exercise visitorial powers over operating subsidiaries only to the extent that they could exercise visitorial powers over a national bank.

[10] Moreover, the rule is fully consistent with the Riegle-Neal Act, which specifically provided that the provisions of any State law to which a branch of a national bank is subject under the Act *"shall be enforced, with respect to such branch, by the Comptroller of the Currency."* 12 U.S.C. § 36(f)(1)(B). Thus, when State law is applicable to interstate branches of national banks, the OCC is required to enforce such laws.

[11] *See* Footnote 28 in Brief of Amici Curiae of 41 State Attorneys General in Support of Defendant, in *Wachovia Bank, N.A. v. Watters*, Civil Action No. 5:03CV0105, U.S. District Court for the Western District of Michigan, January 29, 2004.

Some of the comments we received during the rulemaking process and some reactions to the final rules characterize them as "radical" or "dramatic" departures from the *status quo*. That characterization is simply incorrect.

The standard used in the preemption rule encapsulates the standards that the United States Supreme Court has applied in preemption cases for well over 130 years. It is phrased in words – "obstruct, impair, or condition" – that are taken from those cases. We have emphasized that we are not creating a new test for the threshold of preemption. The types of State laws identified as preempted in the rule include types of laws that a Federal court has previously held, or that the OCC has previously opined, are preempted, or that are already preempted under existing OCC regulations. The other types of laws listed as preempted are virtually the same as those listed in OTS regulations that have been on the books since 1996. The clarifications we have added to our existing visitorial powers rule reinforce the point that the statutory prohibition on the exercise of visitorial powers by authorities other than the OCC means what the text clearly says. No one other than the OCC is empowered to regulate or supervise the banking business of national banks unless Federal law provides that authority, and the statutory prohibition cannot be defeated by resort to the courts to impose regulatory standards or sanctions that the statute forbids State authorities from imposing directly.

What, then, has changed? What is different is that the legal conclusions that we have reached – and that have been reached in the context of comparable Federally chartered institutions – in preexisting rules, in legal opinions, orders, and sometimes briefs in litigation, are now collected together in one place and codified in rules. Now, all national banks can look to one source to identify specific and predictable standards to define their compliance responsibilities with regard to specified types of State laws. This is critically important if national banks are to be able to operate efficiently and exercise fully the powers that Federal law gives them.

III. The OCC's Commitment to Consumer Protection

The OCC's preemption rule both contains an anti-predatory lending standard and reaffirms the applicability to national banks of the prohibition on unfair and deceptive practices that is contained in the FTC Act. The addition of these provisions to our lending rules reinforces the obligations of national banks and their operating subsidiaries to treat their customers fairly and operate pursuant to high standards of integrity. Moreover, it is a consistent outgrowth of a series of actions we have taken to deter abusive lending practices and insure fair treatment of national bank customers.

It bears repeating that there is scant evidence that national banks and their operating subsidiaries are engaged in predatory practices. This conclusion is borne out not only by our own supervisory experience, but also by an extensive study of predatory lending conducted by the Department of Housing and Urban Development (HUD) and the Treasury Department.[12]

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[12] A Treasury-HUD joint report issued in 2000 found that predatory lending practices in the subprime market are less likely to occur in lending by –

> banks, thrifts, and credit unions that are subject to extensive oversight and regulation . . . . The subprime mortgage and finance companies that dominate mortgage lending in many low-income and minority communities, while subject to the same consumer protection laws, are not subject to as much federal oversight as their prime market counterparts – who are largely federally-supervised banks, thrifts, and credit unions. The absence of such accountability may create an environment where predatory practices flourish because they are unlikely to be detected.

Moreover, in a brief submitted in support of an OTS rulemaking concerning preemption of State lending standards, 46 State Attorneys General said that:

> predatory lending abuses are largely confined to the subprime mortgage lending market and to *non-depository institutions. Almost all of the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries.* * * * .
>
> Recent major state Attorneys General and Federal Trade Commission enforcement actions and settlements targeting predatory lending activities have all involved state housing creditors – namely, non-bank finance companies – and not supervised depository institutions * * *
>
> The Attorneys General are not aware of any similar actions relating to predatory mortgage lending directed against federal thrifts or national banks.[13]

All 50 State Attorneys General reiterated this point in their comment letter to the OCC on the proposal that preceded our final preemption rule, saying:

> It is true that most complaints and state enforcement actions involving mortgage lending practices have not been directed at banks. However, most major subprime mortgage lenders are now subsidiaries of bank holding companies, (*although not direct bank operating subsidiaries*).[14]

It is important, in our view, that the Attorneys General, who have been clear about their disagreement with our preemption rule, have not found national banks and their operating subsidiaries to be engaged in predatory lending to any discernable degree. I mention the point here, by way of preface, in order to emphasize that the approach the OCC has taken to combating

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Departments of Housing and Urban Development and the Treasury, "Curbing Predatory Home Mortgage Lending: A Joint Report" 17-18 (June 2000), *available at* http://www.treas.gov/press/releases/report3076.htm.

In addition, the report found that a significant source of abusive lending practices is non-regulated mortgage brokers and similar intermediaries who, because they "do not actually take on the credit risk of making the loan, . . . may be less concerned about the loan's ultimate repayment, and more concerned with the fee income they earn from the transaction." *Id.* at 40.

[13] Brief for Amicus Curiae State Attorneys General, *Nat'l Home Equity Mortgage Ass'n v. OTS*, Civil Action No. 02-2506 (GK) (D.D.C.) at 10-11, 12 (emphasis added).

predatory and abusive lending practices is tailored, appropriately, to the extent that the issue exists in the national banking system.

The OCC's Anti-Predatory Lending Standards

The OCC is the first, and thus far the only, Federal banking agency to issue anti-predatory lending guidance. Two advisory letters issued a year ago provide comprehensive supervisory guidance directed at ensuring that national banks and their operating subsidiaries do not become involved in abusive or predatory mortgage lending practices.[15]

The OCC's supervisory guidance details steps for national banks to take to ensure that they do not engage in such practices. The guidance makes clear that national banks should adopt policies and procedures to prevent predatory lending practices in direct lending *and* in transactions involving brokers and purchased loans. Each of the Advisory Letters expressly covers national banks as well as their operating subsidiaries.

Significantly, AL 2003-2 provides that bank policies and procedures on direct lending should reflect the degree of care that is appropriate to the risk of a particular transaction. In some cases, this will entail making the determination that a loan is reasonably likely to meet the borrower's individual financial circumstances and needs. We also emphasize that if the OCC has evidence that a national bank or its operating subsidiary has engaged in abusive lending practices, we will review those practices, not only to determine whether they violate specific provisions of law

[14] National Association of Attorneys General, Comment Letter Re: Docket No. 03-16 (dated Oct. 6, 2003) at 10 (emphasis added).

[15] *See* OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 18, 2003; OCC Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 18, 2003.

such as the Home Ownership and Equity Protection Act of 1994 (HOEPA), the Fair Housing Act, or the Equal Credit Opportunity Act, but also to determine whether they involve unfair or deceptive practices that violate the FTC Act. Indeed, several practices that we identify as abusive in our standards – such as equity stripping, loan flipping, and the refinancing of special subsidized mortgage loans that originally contained terms favorable to the borrower – could well be found to be unfair practices that violate the FTC Act.

We issued our second advisory, AL 2003-3, to address concerns that have been raised about the all-too-common link between predatory lending and non-regulated lending intermediaries, and to address the risk that a national bank could indirectly facilitate predatory lending through the purchase of loans and mortgage-backed securities and in connection with broker transactions. Our guidance stresses that national banks need to perform adequate due diligence prior to entering into any relationships with loan brokers, third-party loan originators, and the issuers of mortgage-backed securities, to ensure that the bank does not do business with companies that fail to employ appropriate safeguards against predatory lending in connection with loans they arrange, sell, or pool for securitization. We also advise national banks to take specific steps to address the risk of fraud and deception in brokered loan transactions relating to broker-imposed fees and other broker compensation vehicles.

The OCC's Examination and Supervisory Processes

The OCC conducts comprehensive examinations of a national bank's business, including its adherence to safe and sound banking practices and its compliance with several dozen Federal consumer protection laws. Through a network of examiners located throughout the U.S., we monitor conditions and trends, both in individual banks and in the national banking system as a whole. Our supervisory activities focus on the risks as identified by our supervisory monitoring tools and subject matter experts. Federal law requires that the OCC examine national banks at least once every 12 or 18 months, depending on the size and condition of the bank.[16] However, the largest national banks have on-site examination teams conducting continuous examinations of all aspects of the bank's operations. In addition, the OCC may at any time conduct targeted safety and soundness and compliance examinations.

This system of supervision applies to national banks and their operating subsidiaries. The OCC supervises national banks by business line, not according to corporate form, so the standards applied in the course of that supervision are the same for national banks and their operating subsidiaries. The book figures of a parent national bank and its operating subsidiaries are combined for purposes of applying statutory or regulatory limits, such as lending limits or dividend restrictions. The OCC reviews the institution's policies and procedures in an effort to assess whether they adequately identify and address the risks the institution may face, given the nature and scope of its business. Finally, the OCC evaluates the adequacy of all elements of the institution's business, including capital, earnings, assets, management, liquidity, sensitivity to market risk, and information systems.

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[16] 12 U.S.C. § 1820(d)(1). The general rule requires examinations every 12 months. However, if a bank has less than $250 million in assets and is in good condition, the OCC need only examine it at least once every 18 months. *Id.* § 1820(d)(4).

Through our safety and soundness and compliance examinations, the OCC reviews the adequacy of the bank's policies, systems and controls, relative to the character and complexity of the bank's business and assesses whether the bank's activities are being carried out in compliance with applicable laws and regulations. As part of these reviews, examiners typically sample transactions to assess the adequacy of the bank's systems and controls. For example, as part of an asset quality review, the sample of loans will be reviewed to determine the quality of the loans, the adequacy and completeness of the information concerning the loan and the borrower, and whether the lending function is being carried out in compliance with applicable laws.

Depending on the bank's risk profile and other supervisory information, examiners may target their reviews to a particular loan product, business line, or operating unit. For example, if the bank is engaging in significant new or expanded mortgage lending activities through an operating subsidiary, examiners normally would select a sample of those loans for review. Similarly, as part of our compliance reviews, examiners may select a sample of consumer loan or deposit products to verify that the bank's systems and controls are adequate and that the bank is complying with applicable consumer protection laws and regulations. If the sampling process indicates potential issues, we will expand our reviews as appropriate. The examination process is intended to provide a high level of assurance that each aspect of an institution's business is conducted in compliance with applicable laws and on a safe and sound basis. Through this process, we are able to examine national banks and their operating subsidiaries for potentially abusive lending practices as well as compliance with the host of specific Federal consumer protection requirements to which they are subject.[17] Our compliance supervision is an integral part of our comprehensive, ongoing oversight of the national banking system.

Today, the OCC supervises approximately 2100 national banks, together with their operating subsidiaries. Compliance and enforcement at the OCC are carried out through our corps of bank examiners and attorneys. We have nearly 1700 examiners in the field, hundreds of whom are involved in both safety and soundness and compliance supervision. Over 100 examiners throughout the country work exclusively on compliance supervision. We have over 300 examiners on site at our largest national banks, engaged in continuous supervision of all aspects of their operations. These resources are supplemented by dozens of attorneys in our district offices and Washington D.C. who work on compliance matters.

The 40 employees in our Customer Assistance Group (CAG) located in Houston, Texas, further supplement these functions. The CAG provides direct assistance to customers of national banks and their subsidiaries to resolve individual complaints. It also collates and disseminates complaint data that help point our examiners toward banks, activities, and products that require further investigation or transaction testing through product sampling. While the CAG is an important supplement to our compliance supervision functions, it is by no means all there is to it.

[17] Federal consumer protection laws and regulations that apply to national banks and to national bank operating subsidiaries include: the Federal Trade Commission Act; Truth in Lending Act; Home Ownership and Equity Protection Act; Fair Housing Act; Equal Credit Opportunity Act; Real Estate Settlement Procedures Act; Community Reinvestment Act; Truth in Savings Act; Electronic Fund Transfer Act; Expedited Funds Availability Act; Flood Disaster Protection Act; Home Mortgage Disclosure Act; Fair Housing Home Loan Data System; Credit Practices Rule; Fair Credit Reporting Act; Federal Privacy Laws; Fair Debt Collection Practices Act; the new OCC anti-predatory lending rules in 12 C.F.R. Parts 7 and 34; OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements; OCC standards on unfair and deceptive practices (http://www.occ.treas.gov/ftp/advisory/2002-3.doc.); and OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions (http://www.occ.treas.gov/ftp/advisory/2003-2.doc. and http://www.occ.treas.gov/ftp/advisory/2003-3.doc.).

By way of comparison, based on data published by the Conference of State Bank Supervisors, State banking departments collectively supervise approximately 113,000 entities, of which approximately 6,000 are commercial banks.[18] For all these entities, the States report that they have 2,308 examiners.[19] Thus, if one were to look only at commercial banks and assume all State examiners were dedicated to commercial bank supervision, OCC's resources exceed those of the States on a per-supervised bank basis. But, in fact, State banking departments are responsible for many entities in addition to commercial banks. These include, depending on the State, savings banks, thrifts, bank holding companies, mortgage bankers and brokers, industrial loan companies, non-bank trust companies, money transmitters, consumer finance companies, other licensed lenders, payday lenders, title lenders, check cashers, pawnshops, bankers' banks, securities brokers and dealers, and funeral parlors. Thus, on a per-supervised entity basis, the OCC has significantly more resources than do the States. This is exactly the opposite of what some critics of our regulations have suggested. These suggestions – that our resources are inadequate to enable the OCC to supervise compliance effectively or to fulfill the consumer protection aspect of our mission – are without foundation.

Moreover, we continue to act on our strong commitment to preventing abusive or predatory lending practices in the national banking system and ensuring that the institutions we supervise adhere to high standards of customer service, integrity. Recently, for example, the OCC issued a new advisory letter to national banks clarifying our expectations about how they should handle

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[18] *A Profile of State Chartered Banking*, Nineteenth Edition, 2002-2003, Conference of State Bank Supervisors.

[19] *Id.* See attached chart.

customer complaints that are forwarded to them from State agencies and departments.[20] We took that opportunity to emphasize the importance of resolving consumer complaints fairly and expeditiously, regardless of the source of the complaint, and to remind banks that their complaint resolution processes are subject to review as part of our regular supervision of their compliance management programs.

If, as a result of our examination or supervisory processes, or upon investigation of referrals or complaints, we find abusive practices in a particular institution, we take action to stop them. As I next describe, the OCC has a wide array of effective enforcement tools that we can use to do so.

The OCC's Enforcement Program

Section 8 of the Federal Deposit Insurance Act gives the OCC broad powers to compel compliance with any "law, rule, or regulation." This includes the ability to issue cease and desist orders when the OCC determines that a national bank or its operating subsidiary has violated any applicable Federal law or regulation or any applicable State law or regulation.[21] In an appropriate case, the cease and desist order may include restitution or a requirement for such other affirmative action as the OCC determines is appropriate.[22] Our record shows that we have

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[20] OCC Advisory Letter 2004-2, "Consumer Complaints Referred to National Banks from State Officials," February 26, 2004.

[21] 12 U.S.C. § 1818(b)(1). *See National State Bank of Elizabeth, N.J. v. Long*, 630 F.2d 981, 988-89 (3d Cir. 1980) (confirming the OCC's authority under 12 U.S.C. § 484 to enforce an applicable State redlining statute).

[22] 12 U.S.C. § 1818(b)(6).

been willing and able to use these remedies to protect customers and to address unfair, deceptive, or abusive practices when such situations occur.

- The OCC was the first Federal banking agency to take enforcement action against an institution it supervises for violations of Section 5 of the FTC Act. In a groundbreaking case, the OCC asserted section 5 of the FTC Act as a basis for seeking a cease and desist order, as well as affirmative remedies, against Providian National Bank.[23] The bank's settlement of that matter with the OCC required that it pay over $300 million in restitution to customers who had been the victims of unscrupulous marketing practices in connection with its "credit protection" program. Restitution through this single action was available to thousands of the bank's customers, nationwide.

- We have continued to bring actions based on violations of section 5 of the FTC Act where practices warrant. We have obtained millions of dollars in restitution for national bank customers in cases including:

  - In the Matter of Clear Lake National Bank, San Antonio, Texas, Enforcement Action 2003-135 (required restitution of fees, finance charges, and interest re so-called "tax lien loans").

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[23] In the Matter of Providian National Bank, Tilton, New Hampshire (June 28, 2000). *See also* Agreement By and Between First National Bank, Ft. Pierre, South Dakota and the OCC (July 18, 2002) (formal agreement requiring national bank to cease violations of section 5 of the FTC Act in connection with the solicitation of credit cards).

- In the Matter of First Consumers National Bank, Beaverton, Oregon, Enforcement Action 2003-100 (required restitution of annual fees and overlimit fees for credit cards).

- In the Matter of Household Bank (SB), National Association, Las Vegas, NV, Enforcement Action 2003-17 (required restitution re private label credit cards).[24]

- In the Matter of First National Bank in Brookings, Brookings, South Dakota, Enforcement Action 2003-1 (restitution re: credit cards).

- In the Matter of First National Bank of Marin, Las Vegas NV, Enforcement Action 2001-97 (restitution re: credit cards).

- In the Matter of Direct Merchants National Bank, Scottsdale, AZ, Enforcement Action 2001-24 (restitution re: credit cards).

* We have moved aggressively against national banks engaged in payday lending programs that involved consumer abuses as well as practices inconsistent with safety and soundness. Specifically, we concluded the following four enforcement actions against national banks that had entered into contracts with payday lenders for loan originations, in each case ordering the bank to terminate the relationship with the payday lender:

[24] In an action brought by the State of Arizona against this bank, among others, a State court recently observed that the restitution and remedial action that had been ordered by the OCC against the bank was "comprehensive and significantly broader in scope that that available through [the] State court proceedings." *State of Arizona v. Hispanic*

- In the Matter of Peoples National Bank, Paris, Texas, Enforcement Action 2003-2. We also assessed civil money penalties against Peoples National Bank in this matter for violating Federal consumer protection statutes.

- In the Matter of First National Bank in Brookings, Brookings, South Dakota, Enforcement Action 2003-1 (as noted previously, we also ordered restitution in this action).

- In the Matter of Goleta National Bank, Goleta, California, Enforcement Action 2002-93. We also assessed civil money penalties against Goleta National Bank in this matter for violating Federal consumer protection statutes.

- In the Matter of Eagle National Bank, Upper Darby, Pennsylvania, Enforcement Action 2001-104.

The OCC is authorized to take the same enforcement actions and order the same remedies against national bank operating subsidiaries as we can against national banks.

The following are examples of enforcement actions we have taken where the basis for the action or the remedy ordered, or both, involved a national bank operating subsidiary:

Air Conditioning and Heating, Inc., CV 2000-003625, Ruling at 27 (Aug. 25, 2003) (Superior Court of Arizona, Maricopa County).

- NationsBank, N.A., Charlotte, NC (now known as Bank of America, N.A.)

  The OCC assessed a $750,000 civil money penalty against NationsBank for unsafe or unsound practices at NationsSecurities, Inc., an operating subsidiary, relating to the sale of non-deposit products to customers. The OCC determined that NationsSecurities violated a condition of the OCC's approval of NationsBank's operating subsidiary notice. The condition related to providing appropriate disclosure to customers concerning the uninsured nature of the non-deposit products being sold and the relationship of the involved entities to the products.

- Advanta National Bank, Philadelphia, PA

  The OCC issued a Consent Cease and Desist Action and two Formal Agreements to address numerous violations of law and unsafe and unsound banking practices conducted through the bank's mortgage lending subsidiary, and to require the disposition of the bank's mortgage lending operation.

- Household Bank (SB), N.A., Las Vegas, NV

  The OCC issued a Formal Agreement against the bank requiring restitution to be paid to customers for unsafe or unsound practices and violations of consumer laws by the bank's retail services operating subsidiary in connection with solicitation and remediation of customers' complaints concerning the bank's credit cards.

- First Consumers National Bank, Beaverton, Oregon

  The OCC issued a Consent Order in May 2002 against the bank requiring it to review all transactions with its affiliates and subsidiaries and to obtain any restitution owed to the bank from such entities, including a securitization operating subsidiary, resulting from violations of affiliate transaction laws and unsafe/unsound contracts. The OCC also required the bank (and, consequently, its subsidiary) to liquidate.

The national banking system today is safe and sound, and the operations of national banks reflect high standards. We are committed to assuring that this is always the case. In those exceptional cases where those standards are not met, we have the legal authority, the resources, and the commitment necessary to pursue appropriate sanctions and remedies.

Finally, as I noted early on in this statement, the preemption regulation that we adopted is substantially identical to the preemption regulations of the OTS that have been applicable to Federal thrifts for a number of years. It does not appear from public commentary – nor have State officials indicated – that OTS preemption regulations have undermined the protection of customers of Federal thrifts. There is no reason to expect that the results will be different for the customers of national banks.

IV. The OCC's Reasons for Adopting the Regulations

Precedents of the Supreme Court dating back to 1869 have addressed preemption in the context of national banks and have consistently and repeatedly recognized that national banks were designed by Congress to operate, throughout the nation, under uniform, Federally-set standards of banking operations. As a result, there is an extensive body of Federal court precedents that reiterate and apply preemption principles to a variety of different types of State laws.[25] Yet, banks increasingly have been forced to litigate – sometimes repeatedly on the same issue – to clarify the applicability of specific types of State laws, and the OCC has issued separate legal opinions that address the applicability of State law. As national banks operate in an increasingly complex and multi-state environment, the shortcomings of this expensive and time-consuming case-by-case approach have become increasingly apparent. In addition, the financial and opportunity costs to banks of a case-by-case approach may be significant – especially where litigation becomes necessary to establish clear standards.

Rather than continuing to address preemption issues on a piecemeal basis, the preemption rules address them collectively – by clarifying and codifying prior judicial and OCC interpretations based on long-established Constitutional principles – to provide clear ground rules for national banks concerning the applicability of specified types of State laws.

[25] *See, e.g., Bank of America v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 123 S. Ct. 2220, 2003 U.S. LEXIS 4253 (May 27, 2003) (the National Bank Act and OCC regulations together preempt conflicting State limitations on the authority of national banks to collect fees for the provision of electronic services through ATMs; municipal ordinances prohibiting such fees are invalid under the Supremacy Clause); *Wells Fargo Bank, Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003) (Texas statute prohibiting certain check cashing fees is preempted by the National Bank Act); *Metrobank v. Foster*, 193 F. Supp. 2d 1156 (S.D. Iowa 2002) (national bank authority to charge fees for ATM use preempted Iowa prohibition on such fees). *See also Bank One, Utah v.*

The changing financial services marketplace

As explained in the preamble to the preemption rule, markets for credit, deposits, and many other financial products and services are now national, if not international, in scope, as a result of significant changes in the financial services marketplace, particularly in the last 20 years. Now, more than ever before, the imposition of an overlay of 50 State and an indeterminate number of local standards and requirements on top of the Federal requirements and OCC supervisory standards to which national banks already are subject has costly consequences that can materially affect a national bank's ability to serve its customers.

The changes we see in the market for financial services are the result of a combination of factors, including technological innovations, the erosion of legal barriers, and an increasingly mobile society.

Technology has expanded the potential availability of credit and made possible virtually instantaneous credit decisions. Mortgage financing that once took weeks, for example, now can take only hours, with customers located throughout the nation obtaining mortgages based on sophisticated credit-scoring derived from centralized credit underwriting facilities. Consumer credit can be obtained at the point of sale at retailers and even when buying a major item such as a car. Consumers can shop for investment products and deposits on-line, from providers whose location may well be irrelevant. With respect to deposits, consumers can compare rates and

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Guttau, 190 F.3d 844 (8th Cir. 1999), *cert. denied sub nom Foster v. Bank One, Utah*, 529 U.S. 1087 (2000) (holding that Federal law preempted Iowa restrictions on ATM operation, location, and advertising).

duration of a variety of deposit products offered by financial institutions located far from where the consumer resides.

Changes in applicable law also have contributed to the expansion of markets for national banks and their operating subsidiaries. These changes have affected both the type of products that may be offered and the geographic region in which banks – large and small – may conduct business. As a result of these changes, banks may branch across State lines and offer a broader array of products than ever before. An even wider range of customers can be reached through the use of technology, including the Internet. Community national banks, as well as the largest national banks, reach customers across State lines and use new technologies to expand their reach and service to customers.

Our modern society is also highly mobile. Forty million Americans move annually, according to a recent Congressional report issued in connection with enactment of the Fair and Accurate Credit Transactions Act of 2003.[26] And when they move, they often have the desire, if not the expectation, that the financial relationships and status they have established will be portable and will remain consistent.

These developments highlight the significance of being able to conduct a banking business pursuant to consistent, national standards, regardless of the location of a customer when he or she first becomes a bank customer or the location to which the customer may move *after* becoming a bank customer. They also accentuate the costs and interference that diverse and

[26] *See* S. Rep. No. 108-166, at 10 (2003) (quoting the hearing testimony of Secretary of the Treasury Snow).

potentially conflicting State and local laws have on the ability of national banks to operate under the powers granted by their Federal charter.

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, and their customers may face higher costs or more limited product offerings – or both – as a result. The application of multiple, often unpredictable, different State or local restrictions and requirements prevents them from operating in the manner authorized under Federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential financial exposure. In some cases, this deters them from making certain products available in certain jurisdictions. As was recently observed by Federal Reserve Board Chairman Alan Greenspan, "increased costs resulting from restrictions that differ based on geography, may lead to an increase in the price or a reduction in the availability of credit, as well as a reduction in the optimal sharing of risk and reward."[27]

It has been suggested that the ability to do business in multiple States, under uniform, consistent and predictable standards, primarily benefits the largest banks. In fact, for community and intermediate-sized banks with customers in multiple jurisdictions, this attribute of the national bank charter may have even more practical significance than for a "megabank." Take, for example, a community bank with customers in a multi-state metropolitan area like New York or Philadelphia or Washington, D.C.; or a community bank with customers in a compact multi-state

[27] Letter of February 28, 2003, from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to The Honorable Ruben Hinojosa (cited by Congressman Hinojosa on November 21, 2003, during House debate on the Conference Report to accompany H.R. 2622 (Conference Report 108-396)).

region, such as New England; or any State-based bank in a State in which cities or municipalities enact unique local requirements for bank operations. Community and intermediate-sized regional banks have a smaller base of operations, *e.g.*, a smaller number of loans, over which they are able to spread the overhead costs of legal staff, compliance staff, technology, and printing costs necessary to comply with multiple State (and potentially local) requirements. This drives up their costs, and detracts from their ability to compete effectively with larger banks that have a bigger base of operations over which to apply overhead costs. This, in turn, serves as a disincentive for those banks to incur still more costs by expanding service to customers in a new State. Ultimately, the inability to compete on a cost-effective basis can be a factor that contributes to management decisions to merge or be acquired by a larger institution.

As we have learned from our experience supervising national banks, from the inquiries we have received, by the extent of litigation in recent years over these State efforts, and by the comments we received during our rulemakings, national banks' ability to conduct operations to the full extent authorized by Federal law has been impaired as a result of increasing efforts by States and localities to apply State and local laws to national banks. For example, commenters on our proposal to adopt the preemption rule noted that the variety of State and local laws that have been enacted in recent years – including laws regulating fees, disclosures, conditions on lending, and licensing – have created higher costs, increased risks, and operational impediments.[28] Other commenters noted the proliferation of State and local predatory lending laws and the impact that

[28] Illustrative of comments along these lines were those of banks who noted that various State laws would result in the following costs: (a) approximately $44 million in start-up costs incurred by 6 banks as a result of a recently-enacted California law mandating a minimum payment warning; (b) 250 programming days required to change one of several computer systems that needed to be changed to comply with anti-predatory lending laws enacted in three States and the District of Columbia; and (c) $7.1 million in costs a bank would incur as a result of complying with mandated annual statements to credit card customers.

those laws are having on lending in the affected jurisdictions. As a result, national banks must absorb the costs, pass the costs on to consumers, or simply curtail lending in jurisdictions where the costs are prohibitive or risks are imprudent. Commenters noted that this result occurs even in situations where a bank concludes that a law is preempted, simply so that the bank may avoid litigation costs or anticipated reputational injury.

Even the efforts of a single State to regulate the operations of a national bank operating only within that State can have a detrimental effect on that bank's operations and consumers. For example, the impact of particular State laws on the mortgage market and credit availability is discussed in detail, below.

Access to the secondary mortgage markets

The continuing uncertainty about the applicability of State laws has already affected national banks' ability to lend in certain markets and to access the secondary market, a curtailment of their business that is inconsistent with their Federally authorized powers and that has the potential to adversely affect credit availability as well as detract from the banks' financial position.

The trend at the State and local levels toward enacting legislation that seeks to impose costly and inconsistent compliance burdens on national banks has accelerated in recent years. These laws are well-intentioned but nonetheless curtail national banks' ability to conduct operations to the full extent authorized by Federal law and can disrupt credit delivery systems.

For example, in recent years, various States and localities have enacted predatory lending laws, each employing a combination of standards that differs in some respects from the others, but each typically singling out loan product features and either barring loans with those features or imposing requirements that make it very costly for lenders to offer them. The goals of these laws – to eliminate predatory and abusive mortgage lending practices – are laudable and we strongly support their objectives. As I have repeatedly said, predatory and abusive practices have no place in the national banking system, and, as I have shown, we will take vigorous action to assure that this is the case.

However, these State and local law approaches can have the effect of banning subprime loans based on certain loan terms. They generally prohibit certain mortgage loan terms and impose extra compliance obligations when certain other loan terms or conditions are present. They introduce new standards for subprime lending that are untested, sometimes vague, often complex, and different from established Federal requirements. They also create new potential liabilities and penalties for any lender who missteps in its efforts to comply with those new standards and restrictions. These laws materially increase a bank's costs and compliance and reputation risks, especially in connection with risk-based pricing to the subprime market.

It is important to understand that this approach, while intended to stop abusive practices, also can work to constrain legitimate risk-priced lending to credit-worthy subprime borrowers.[29] Like any State regulator, the OCC is dedicated to ensuring that the institutions we supervise are not engaged in abusive or predatory lending practices. However, our approach is to focus on preventing those *practices,* not on banning or restricting specified loan products or terms in the absence of evidence of abusive, predatory, unfair, or deceptive practices.

Often, State and local predatory lending laws that have such a *product-* rather than *practice-* focus have created uncertainties that adversely affect banks' ability to access the secondary market for legitimate, risk-priced mortgage loans. When a bank is able to sell a loan on a cost-effective basis to Fannie Mae or Freddie Mac, or obtains a rating for a pool of loans that it "securitizes" and sells to investors, the bank is able to liquify its loans and redeploy capital to make additional loans available. If Fannie or Freddie are unwilling to purchase loans made in jurisdictions with specialized predatory lending restrictions and potential liabilities, the funds banks have available to make additional credit available are diminished. Similarly, if a bank is unable to obtain a rating from Standard and Poors' (S&P), Moody's Investors Services, or Fitch Ratings, it will not be able to securitize its loans on a cost-effective basis and redeploy capital to make additional credit available. In other words, localized and State-based restrictions on loan terms substantially affect the marketability of such loans, and that, in turn, affects overall credit availability.

[29] It is important to note that many legitimate, risk-priced mortgage loans would be considered "high cost home loans" under some State anti-predatory lending laws. For example, a "high cost" home loan under Georgia's anti-predatory lending law includes mortgages that have total points and fees exceeding 5% of the loan amount if the mortgage is $20,000 or more. On a $30,000 mortgage, this would mean any loan with origination fees of more than $1,500 would be considered "high cost." According to the Mortgage Bankers Association's 2002 Cost Study, the average cost to originate a mortgage in 2001 was $1,744.

Fannie Mae and Freddie Mac have both issued policies concerning their willingness to purchase residential mortgage loans subject to various State predatory lending laws. Fannie Mae and Freddie Mac will not purchase high cost home loans from **Arkansas, Georgia, Kentucky, Illinois, Maine, Nevada, New Jersey, New Mexico, New York, and Oklahoma**.

S&P, Moody's, and Fitch have also issued policies concerning the inclusion of high cost loans from jurisdictions with predatory lending laws in structured finance transactions.[30] Under these policies, the rating agencies generally will not rate residential mortgage-backed securities (RMBS) structured finance transactions containing loans that carry unquantifiable assignee liability. Therefore, high-cost loans originated in States with anti-predatory lending laws providing for uncapped or unascertainable assignee liability must generally be excluded from a securitization in order for the transaction to be rated. [31]

S&P and Fitch will rate securitizations containing loans originated in States with anti-predatory lending laws that provide for limited, or quantifiable, assignee liability, but only subject to additional credit enhancements and additional representations and warranties. Lenders doing business in the States discussed below face the following additional secondary market constraints:

[30] *See* Standard & Poor's: "Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach" (April 15, 2003); Moody's Investor Services: "Impact of Predatory Lending Laws on RMBS Securitizations" (May 6, 2003); and Fitch Press Release: "Fitch Revises its Rating Criteria in the Wake of Predatory Lending Legislation" (May 1, 2003).

[31] *See, e.g.,* "Standard & Poor's Permits Additional New Jersey Mortgage Loans Into Rated SF Transactions" (Nov. 25, 2003) ("Standard & Poor's will continue to exclude High-Cost Home Loans because of the potential for uncapped statutory and punitive damages."); and Mortgage Bankers Association Industry News: "Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004)("Since a lender or assignee of any 'high-cost home loan' may be subject to unlimited liability under the Act, Fitch will not rate RMBS transactions containing high-cost home loans originated in New Mexico as of Jan.1, 2004.") .

- **Arkansas, Georgia, Illinois, Maine, Nevada, New York, Oklahoma, North Carolina and South Carolina.** In these States, S&P generally requires that sellers provide representations and warranties that the loans were originated in compliance with all applicable laws and that their compliance procedures effectively identify high cost home loans and determine that the loans do not violate predatory lending laws. Further, S&P requires that the provider of these representations and warranties be sufficiently creditworthy to purchase any loans that are in violation and cover any contingent liability associated with securitizing high cost home loans.[32] Fitch will generally rate securitizations with loans from these jurisdictions (except North Carolina and South Carolina), but it will require additional representations and warranties and may require additional credit enhancements.[33] Fitch has not yet issued a statement with regard to loans originated in North Carolina or South Carolina.
- **Kentucky**. S&P requires sellers to conduct a loan-by-loan review of all high-cost home loans, and provide the representations and warranties noted above before it will allow

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[32] *See* "S&P Addresses Arkansas Home Loan Protection Law" (July 11, 2003); Standard & Poor's: "Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach" (April 15, 2003) (Georgia and New York); "S&P Addresses Illinois High Risk Home Loans Act" (Nov. 17, 2003); "S&P Addresses Amendment to Maine Truth in Lending Act" (Sept. 12, 2003); "S&P Addresses Nevada Anti-Predatory Lending Law"; "S&P Addresses Oklahoma Anti-Predatory Lending Law" (Nov. 18, 2003); and "S&P Addresses North Carolina Anti-Predatory Lending Law" (Feb. 12, 2004).

[33] *See* "Fitch Ratings Responds to Arkansas Predatory Lending Legislation" (June 20, 2003); Mortgage Bankers Association Industry News: "Fitch to Rate RMBS After Amendment to Georgia Predatory Lending Statute, GFLA" (Mar. 14, 2003); Mortgage Bankers Association Industry News: "Fitch Ratings Addresses Illinois Predatory Lending Legislation" (Dec. 15, 2003); "Fitch Ratings Responds to Maine Predatory Lending Legislation" (Sept. 29, 2003); "Fitch Ratings Responds to Nevada Predatory Lending Legislation" (Oct. 3, 2003); Mortgage Bankers Association Industry News: "Fitch: New York State Anti-Predatory Lending Legislation" (Mar. 26, 2003); and "Fitch Ratings Addresses Predatory Lending Legislation of Oklahoma" (Oct. 30, 2003).

high cost home loans from Kentucky in rated transactions. [34] Fitch will not allow any high cost loans from Kentucky in rated transactions. In order to rate a transaction including *any* loans from Kentucky, Fitch requires receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from Kentucky and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in Kentucky. [35]

- **New Jersey**. S&P and Fitch will not rate securitizations with certain high cost home loans from New Jersey.[36] In order to rate a transaction including *any* loans from New Jersey, Fitch requires, as it does in Kentucky, receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from New Jersey and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in New Jersey.[37]
- **New Mexico**. S&P will rate securitizations containing high cost home loans subject to the additional representations and warranties it requires in Arkansas, Georgia, Illinois,

[34] *See* "S&P Addresses Kentucky High-Cost Law" (Jun. 20, 2003).

[35] *See* Mortgage Bankers Association Industry News: "Fitch Ratings Responds to Kentucky Predatory Lending Legislation" (Jun. 30, 2003); and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004).

[36] *See* "S&P Permits Additional New Jersey Mortgage Loans Into Related SF Transactions" (November 25, 2003).

[37] *See* "Fitch Ratings Responds to New Jersey Predatory Lending Legislation" (Jun 5, 2003); and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004).

> Maine, Nevada, New York, North Carolina, and Oklahoma.[38] Fitch, however, will not rate any transaction containing high cost home loans subject to New Mexico's anti-predatory lending law. Fitch notes that assignee liability may be unlimited in the case of punitive damages, which may be imposed for acts found to be reckless or malicious. Fitch further requires that the seller of any New Mexico loan provide adequate evidence that the transaction will enjoy the benefits of the new law's safe harbor from the law's unlimited liability for assignees and purchasers. In order to be protected by this safe harbor, a purchaser/securitizer must conduct due diligence and provide certain representations and warranties. Because it is unclear what constitutes sufficient "due diligence" under the New Mexico statute, Fitch requires the third party certificate and random sampling it requires in Kentucky and New Jersey.[39]

These constraints translate into cost burdens at each stage of the lending process. For example, a rating agency that is willing to rate a RMBS securitization containing high-cost loans at all may, as we have seen, require representations, warranties, sampling, and certifications that go beyond the industry standard. Satisfying these extra conditions may require a bank to increase its compliance staff, provide additional training to both existing and new staff, and pay fees to obtain third-party sampling and certification. If the rating agency requires additional credit enhancement, providing that will generally add to the financial cost of the transaction. Finally, if the bank cannot securitize the loans and must therefore retain them on book, the bank does not realize funds that it could use to make additional loans and the bank will incur carrying costs.

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[38] *See* "S&P Addresses New Mexico's Home Loan Protection Act" (Nov. 25, 2003).

[39] *See* Mortgage Bankers Association Industry News: "Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004).

These costs either will be passed back to the bank's customers or, if the bank concludes they are unacceptably high, will compel the bank to stop making loans covered by State anti-predatory lending laws.

The rating agencies have, however, responded favorably to preemption decisions by the Federal banking agencies. Shortly after Fitch announced that it would not rate residential mortgage backed securitizations containing high cost home loans originated in New Mexico, Fitch also announced that, beginning the day the OCC's preemption rule becomes effective (February 12, 2004), it *will* rate residential mortgage backed securitizations containing loans subject to any State or local anti-predatory lending laws that were originated by OCC-regulated national banks or their operating subsidiaries without additional credit enhancements.[40] This follows Fitch's August 22, 2003, decisions to rate securitizations without additional credit enhancement by OCC-regulated lenders in Georgia in light of the OCC's Preemption Order and Determination concerning the GFLA,[41] and by OTS-regulated lenders in all jurisdictions in light of the OTS's preemption regulations and various preemption opinions.[42]

On October 3, 2003, S&P made the same decision concerning the GFLA Determination and Order.[43] On March 3, 2004, S&P announced that it had completed its review of the real estate

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[40] *See* "Fitch Ratings Addresses Preemption Statement from the OCC" (Jan. 16, 2004).

[41] *See* 68 Fed. Reg. 46264 (Aug. 5, 2003).

[42] *See* "Fitch Ratings Addresses Preemption Statements from the OTS and OCC" (Aug. 22, 2003).

[43] *See* "S&P Announces Position on OCC's Preemption Order for the GFLA" (Oct. 3, 2003).

lending provisions in the OCC's preemption rule[44] and that, as a result, it will rate securitizations containing loans originated by national banks or their operating subsidiaries in Georgia, Illinois, Kentucky, Maine, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, and South Carolina. For loans originated in these jurisdictions, S&P will continue to rely on the seller's representation and warranty that the loans included in the pool were originated in compliance with all applicable laws, including anti-predatory lending laws. In addition, S&P will require legal comfort in the form of an officer's certificate indicating that the originator of the loan is a national bank or a national bank operating subsidiary.[45]

These decisions are critical because, without a certain secondary market for these loans, banks making risk-priced loans covered by this type of State law will be required to hold more of these loans to maturity. This, in turn, ties up more of a bank's capital as it carries the mortgage assets on its books, and adversely affects the ability of the bank to originate or acquire new loans.

As a result of these higher costs and operational challenges, lenders must absorb the costs, pass the costs on to consumers, or discontinue offering various products in jurisdictions where the costs or exposure to uncertain liabilities are prohibitive. It has been reported that three major lenders have announced they will no longer do business in New Jersey because of the State's

[44] On November 25, 2003, having reviewed the OTS's preemption opinions concerning the anti-predatory lending laws in Georgia, New Jersey, New Mexico, and New York, S&P announced that it would no longer apply its published criteria to Federal thrifts and their operating subsidiaries operating in those States. *See* "S&P Announces Position on OTS Preemption Pronouncements" (Nov. 25, 2003).

[45] See "S&P Addresses OCC Rule Regarding Preemption of State Anti-Predatory Lending Laws" (March 3, 2004). S&P said it was unable to conclude with certainty that assignees and purchasers of loans originated by national banks in Arkansas are not subject to liability. Therefore, S&P said, it will continue to apply its previously announced criteria with respect to such loans.

predatory lending law, and at least 18 have significantly limited their lending activities there.[46] As lenders react like this, legitimate credit availability is reduced and consumers will have fewer options for home loans.

V. Correcting Misperceptions about the Preemption and Visitorial Powers Rules

Some of the comments and reaction we have received in response to our rules seem to reflect fundamental misconceptions about the law on which the rules are based, or the effect of the regulations. I welcome the opportunity to address these misconceptions.

1. The OCC's rules do not leave consumers vulnerable to abusive lending practices.

It is simply not the case that national bank customers will become vulnerable to abusive lending practices as a result of our rules. First, national banks and their operating subsidiaries are not where predatory and abusive lending practices are festering. Second, national banks and their operating subsidiaries are governed by strong Federal standards designed to prevent these practices. Third, the OCC deploys substantial resources, nationwide, to ensure that these practices do not gain a foothold in the national banking system. Our examiners and supervisors have available a wide array of supervisory and enforcement tools to identify and remedy any such practices that do occur. Finally, the ability of State authorities to take aggressive action to protect vulnerable consumers from predatory practices by other types of institutions – the very

[46] *See* Paul Muolo and Brad Finkelstein, *Lenders Leaving New Jersey*, Dec. 2003, American Banker-Bond Buyer, Vol 13, No. 3 at 41.

institutions that have been identified as the source of abusive practices – is unaffected by our regulations.

Clearly, there is a real problem with abusive lending practices in this country, but national banks are not the breeding ground. Whatever differences of opinion may exist with the State Attorneys General, they have stated unambiguously in various filings, as I have described, that there is scant evidence that national banks, or their subsidiaries, are engaged in abusive lending practices. Indeed, these State officials have recognized the extent to which banks (and thrifts) are highly regulated and closely supervised, and have credited that regulatory presence for the scarcity of evidence of abusive or predatory practices.

National banks and national bank operating subsidiaries are subject to comprehensive, regular – in the case of large banks, continuous – supervision, and an extensive array of Federal consumer protection laws and regulations – including the anti-predatory lending standard in our new regulation and section 5 of the FTC Act – administered and enforced by the OCC.[47] As I have described, the OCC's consumer compliance program is fully and effectively staffed by examiners and compliance specialists whose work is supported by attorneys and consumer complaint specialists. OCC examinations of national banks and national bank operating subsidiaries are conducted to ensure and enforce compliance with Federal laws and regulations and with supplemental OCC supervisory standards. On those limited occasions where we have found national banks to be engaged in unacceptable practices, we have taken vigorous enforcement

[47] *See supra* note 17.

action.[48] We will continue to use the supervisory measures and enforcement tools available to us to keep such practices out of the national banking system.

Neither the preemption rule nor the revised visitorial powers rule prevents State officials from applying and enforcing generally applicable State laws that do not attempt to control the content or conduct of national banks' banking activities. Our jurisdiction over national banks and their subsidiaries also does not deprive State regulators of a role in protecting consumers in their States, and we welcome the opportunity to work cooperatively with them to further that goal. We have invited State authorities to refer consumer complaints concerning national banks to the OCC, and to bring to our attention concerns that any national bank is engaged in unfair, deceptive, abusive or predatory practices. We have set up special procedures to handle and track referrals from State authorities.

The OCC and the States already cooperate extensively in many respects, referring consumer complaints to the appropriate regulator of the entity generating the complaint, and we welcome additional opportunities to collaborate.[49] Our new Advisory Letter clarifies how national banks should handle consumer complaints that are forwarded to them from State agencies and departments. I firmly believe that we and State authorities share common goals, and we have invited State officials to enter into cooperative, information sharing agreements regarding consumer complaints. I am confident there are ways we can improve how complaints are

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[48] For examples of our enforcement actions, *see supra* pages 20-25.

[49] *See* attached chart.

handled and consumer concerns are identified and resolved, and we welcome further dialogue with State officials to further those goals.

*2. **The OCC is not taking on a "new role" or assuming a "longstanding responsibility" of the States to enforce State consumer protection laws.***

The statutory authority for the OCC's exclusive visitorial powers does not distinguish between visitorial powers for safety and soundness, consumer compliance, operational risk, or any other type of risk faced by a national bank.[50] Given the importance of preventing abusive lending practices, some have nonetheless asserted that State and local laws should apply in addition to the Federal standards to which national banks are subject. They believe that State and local regulators should also involve themselves in supervising the activities of national banks. These critics are asking, in effect, "Isn't it better to have more regulation and more regulators?"

The answer is "Not necessarily." More regulation and more regulators can have their own consequences and are not the answer unless there has been a failure of the existing regulatory regime. That is simply not the case with national banks and their respective subsidiaries.

Adding layers of regulation brings added costs, which may lead to higher prices for customers. It may also have other undesirable collateral consequences, such as diminished product availability. For example, State and local laws that increase a bank's costs and its potential liabilities in connection with subprime loans, which are already high risk, inevitably will cause

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[50] The Riegle-Neal Act bolsters this conclusion, specifically providing that if State community reinvestment, consumer protection, and fair lending laws are not preempted and are applicable to interstate branches of a national bank, those laws are enforced by the OCC. 12 U.S.C. § 36(f)(1).

some legitimate lenders to conclude that the cost and risks are not worth it. The result is diminished credit availability, and legitimate credit options that may otherwise be available to a segment of potentially credit-worthy sub-prime borrowers will be reduced. We believe our approach to combating abusive lending practices does not diminish credit *access* but does effectively target credit *abuses*.

Adding additional *regulators* also has implications. The typical responsibilities of a State Attorney General include prosecuting Medicaid fraud, investigating and prosecuting organized crime, enforcing the State's environmental protection laws, overseeing the integrity of charitable organizations, investigating and litigating civil rights complaints, advocating for consumers stymied by Health Maintenance Organizations (HMOs), enforcing the State's securities laws to combat fraud – the list could literally go on for pages. I have already described the many types of businesses, in addition to banks, that are the responsibility of State banking departments.

Given State budget constraints, State authorities' insistence on trying to add national banks to their already substantial roster of responsibilities is likely to have unfortunate consequences. The allocation of State resources to supervisory and enforcement functions that are already being performed at the Federal level means that those resources will not be used to protect the State's consumers in connection with all the other potential sources of problems those consumers face. The net result is to diminish the availability of State resources to protect consumers in *other* areas – other areas where there *is* evidence of abusive lending – other areas that are not as highly regulated as the banking business.

The OCC's approach to shared responsibilities actually maximizes regulatory oversight to protect consumers. More resources would be deployed to protect more consumers if States apply their resources to the conduct of State supervised entities, the OCC applies its resources to national banks, and State officials refer problems involving national banks that come to their attention to the OCC.

3. The preemption and visitorial powers rules will not demolish the dual banking system.

Some critics have suggested that by codifying in regulations the exclusivity of the OCC's supervision of national banks and the types of State laws that are, or are not, preempted as applied to national banks, the OCC "will demolish" the dual banking system, or "deprive bankers of a choice of charters." We even heard recently that a State legislator was told that our regulation would lead to dismantling of his State's banking department because it would prevent that department from regulating *State banks.*

Some of this rhetoric is, obviously, fanciful. Other comments in the same vein profoundly short-change the qualities of the State banking systems. More fundamentally, the argument being advanced is simply backwards. Distinctions between State and Federal bank charters, powers, supervision, and regulation are not contrary to the dual banking system; they are the essence of it. Clarification of how the Federal powers of national banks preempt inconsistent State laws is entirely consistent with the distinctions that make the dual banking system dual.

The national and State charters each have their own distinct advantages. Indeed, today State banking regulators vigorously assert that the State charter is superior. But many national banks engage in multi-state businesses that may particularly benefit from the efficiency of a uniform, nationwide system of laws and regulations. Customers of national banks enjoy protections that are as strong as -- and in some cases stronger than -- those available to customers of State banks. But they also benefit from the efficiencies of the national banking system, and predictable, uniform, consistent regulation. It is important to remember that the dual banking system offers American consumers a choice -- those who believe the State system offers greater protections, or desirable variety, are free to make that choice.

4. The preemption rule is not a dramatic departure from established, recognized preemption standards and case law.

Some critics of the regulation have claimed that we are using incorrect preemption standards in our preemption rule. They argue that preemption should only occur when State law significantly impairs a national bank's *express* rights under Federal law. These critics also argue that the OCC contends that national banks are immune from State law. These assertions misunderstand the final rule and incorrectly characterize both the OCC's position and the relevant judicial standards for preemption.

First, it is useful to recap how the preemption provisions of the new rule work. The rule addresses the applicability of certain types of State laws to national banks' lending, deposit-taking, and other Federally authorized activities. With regard to all three categories, the rule states the general principle that, except where made applicable by Federal law, State laws do not apply to national banks if they "obstruct, impair, or condition" the bank's exercise of powers granted under Federal law. The rule's preamble makes very clear that these words are not designed to create a new standard of preemption, but rather to distill the various phrases the Supreme Court has used in its preemption decisions.[51] As stated, the phrase does not refer to any particular type of State law and, thus, obviously does not preempt any particular law. By contrast, in the lending and deposit-taking areas, the preemption rule lists certain specific types of State laws that are preempted. In other words, the rule preempts the types of laws described in the rule; other types of laws remain subject to case-by-case evaluation under judicially developed standards, which the rule distills with the phrase "obstruct, impair, or condition." Collectively, the laws listed are virtually identical to those listed as preempted with respect to Federal thrifts in existing regulations of the OTS; many of those listed are *already preempted by virtue of existing OCC regulations*, or have been addressed by OCC preemption opinions or judicial decisions.

The OCC is *not* arguing that national banks are immune from State law. The preemption principles referenced in our new regulation are firmly grounded on standards announced by the Supreme Court and other Federal courts in cases as recent as last year, going back over 130 years, and our authority to adopt the rule is solidly based on our statutes. The final regulation specifically – and meticulously – explains the sources of our authority to issue the regulation and the standards we reference. In a nutshell, the preemption standards derive from Supreme Court and lower Federal court precedents that provide that Federal law can preempt State laws that obstruct (stand as an obstacle), *Hines v. Davidowitz (1941);* impair the efficiency of, *National Bank v. Commonwealth (1869), Davis v. Elmira Savings Bank (1896), McClellan v. Chipman (1896);* or condition the ability of national banks to exercise powers granted under Federal law,

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[51] 69 Fed. Reg. at 1910.

Barnett Bank of Marion County v. Nelson (1996); Franklin National Bank (1954); and that State "legal infrastructure" laws – such as contract, torts, and real property laws -- that do not restrict the content or extent of powers granted under Federal law are **not** preempted. *National Bank v. Commonwealth (1869); McClellan v. Chipman (1896); B of A v. City and County of S.F. (9th Cir. 2002).*

5. There is no presumption against preemption in the case of the national banking laws, as confirmed by Federal case law and the Riegle-Neal Act.

Critics of both the preemption and visitorial powers rules contend that the rules are inconsistent with the presumptive application of State law to national banks, which is embodied in the Riegle-Neal Act. This is incorrect.

As an initial matter, case law, whether decided before or after Riegle-Neal was enacted, is consistent in holding that there is no presumption against preemption in the national bank context. The Supreme Court has said that a presumption against preemption "is not triggered when the State regulates in an area where there has been a history of significant federal presence."[52] Courts have consistently held that the regulation of national banks is an area where there has been an extensive history of significant Federal presence. As recently observed by the U.S. Court of Appeals for the Ninth Circuit, "since the passage of the National Bank Act in 1864, the federal presence in banking has been significant." The court thus specifically concluded that "the presumption against the preemption of State law is inapplicable."[53] Indeed, when analyzing

[52] *U.S. v. Locke,* 529 U.S. 89, 108 (2000) (explaining *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

[53] *Bank of America*, 309 F.3d at 558-59 (citations omitted).

national bank powers, the Supreme Court has interpreted "grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary State law."[54]

The relevant text of the Riegle-Neal Act is fully consistent with these conclusions. As explained in the preamble to the visitorial powers rule, the Riegle-Neal Act sorted out *which* State's laws -- host State or home State – regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, would apply to interstate branches of national banks, and provided that the host State's laws in those areas would apply to national banks *"**except when Federal law preempts the application of such State laws to a national bank.**"* The potential preemption of State laws thus was expressly recognized as possible in the Riegle-Neal legislation itself.

Moreover, the legislative history of the Riegle-Neal Act indicates that Congress expected the OCC to apply traditional, recognized preemption standards in deciding preemption issues, which is exactly what the OCC is doing.

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[54] *Barnett*, 517 U.S. at 32. The *Barnett* Court went on to elaborate:

> [W]here 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. In Franklin Nat. Bank, the Court made this point explicit. It held that Congress did not intend to subject national banks' power to local restrictions, because the federal power-granting statute there in question contained "no indication that Congress [so] intended . . . as it has done by express language in several other instances."

Id. at 34 (emphasis in original) (citations omitted).

Finally, as I mentioned at the outset, the Riegle-Neal Act also specifically provided that the provisions of any State law to which a branch of a national bank is subject under the Act *"shall be enforced, with respect to such branch, by the Comptroller of the Currency."* Thus, the Riegle-Neal Act is entirely consistent with the visitorial powers rule in providing that when State law is applicable to interstate branches of national banks, the OCC is to enforce such laws (in other words, the OCC retains exclusive visitorial authority).

6. The OCC has ample authority to adopt the preemption rule.

As mentioned previously, the OCC's authority to issue the preemption regulation comes from both 12 U.S.C. § 371 (regarding real estate lending) and § 93a (for all other activities). This statutory authority was recognized by the D.C. Circuit two decades ago in *CSBS v. Conover*.[55] In that case, the court expressly held that the Comptroller has the power under § 371 to issue a regulation that preempts aspects of State laws regarding real estate lending and has authority under § 93a more generally to issue regulations preempting State laws that are inconsistent with the activities permissible under Federal law for national banks. In the words of the court:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. *So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state laws.*[56]

[55] 710 F.2d 878 (D.C. Cir 1983).

[56] *Id.* at 878 (emphasis added).

The authority under sections 93a and 371 described by the court in *CSBS v. Conover* amply supports the adoption of regulations providing that specified types of State laws purporting to govern and curtail national banks' lending and deposit-taking activities are preempted.

7. State law applies to national bank operating subsidiaries to the same extent as their parent banks; therefore, the preemption and visitorial powers rules apply to national banks and their operating subsidiaries equally.

As explained previously, the preemption and visitorial powers rules make no changes to the OCC's rules governing the activities of operating subsidiaries. As already set out in 12 C.F.R. §§ 5.34, 7.4006, and 34.1(b), national bank operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent banks, except where Federal law provides otherwise, *e.g*, functional regulation of insurance and securities subsidiaries. Therefore, *by virtue of regulations already in place*, the rules apply equally to national banks and their operating subsidiaries.

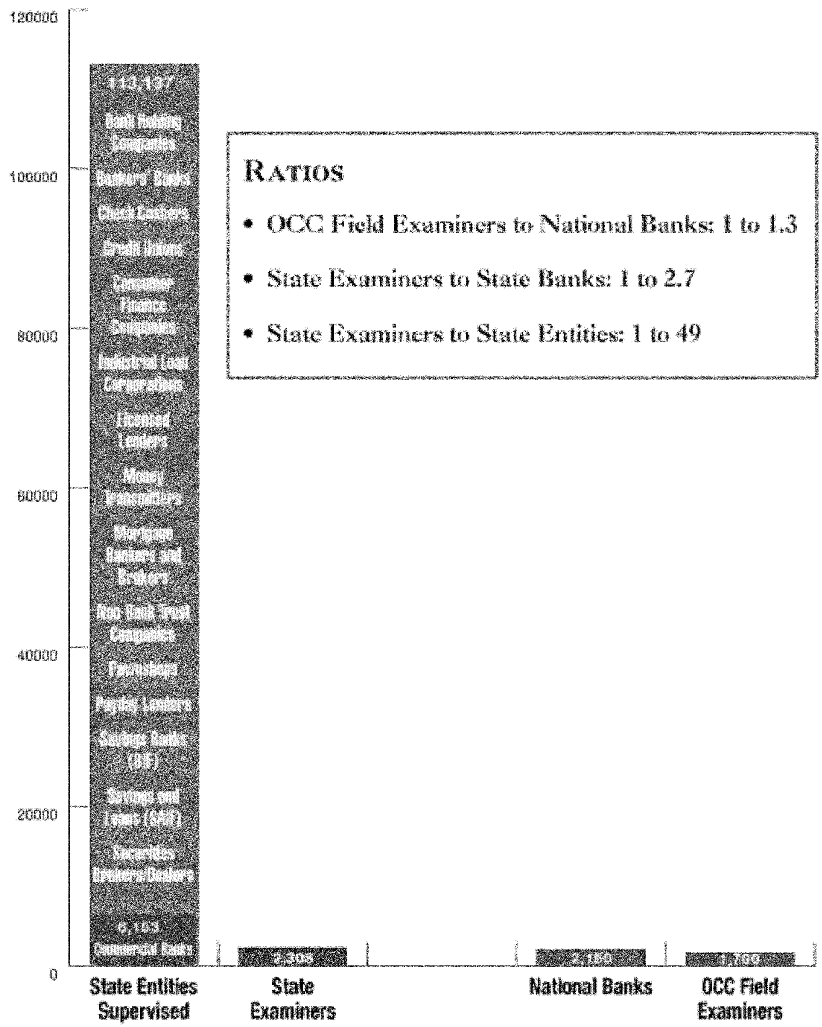
It is important to note that the OCC's position does not implicate the corporate existence or governance rules of State corporations; it concerns the ability of national banks to conduct activities through those entities subject to *Federal* supervision and regulation. National banks conduct authorized activities through operating subsidiaries pursuant to a *Federal license* under OCC regulations and Federal law, and do not need a State license to conduct activities they are authorized to conduct under a *Federal* permit. Operating subsidiaries are thus a Federally authorized means by which national banks may conduct activities authorized under Federal law; as reflected in the OCC's rules, State laws in conflict with that authority must give way.

V. **Conclusion**

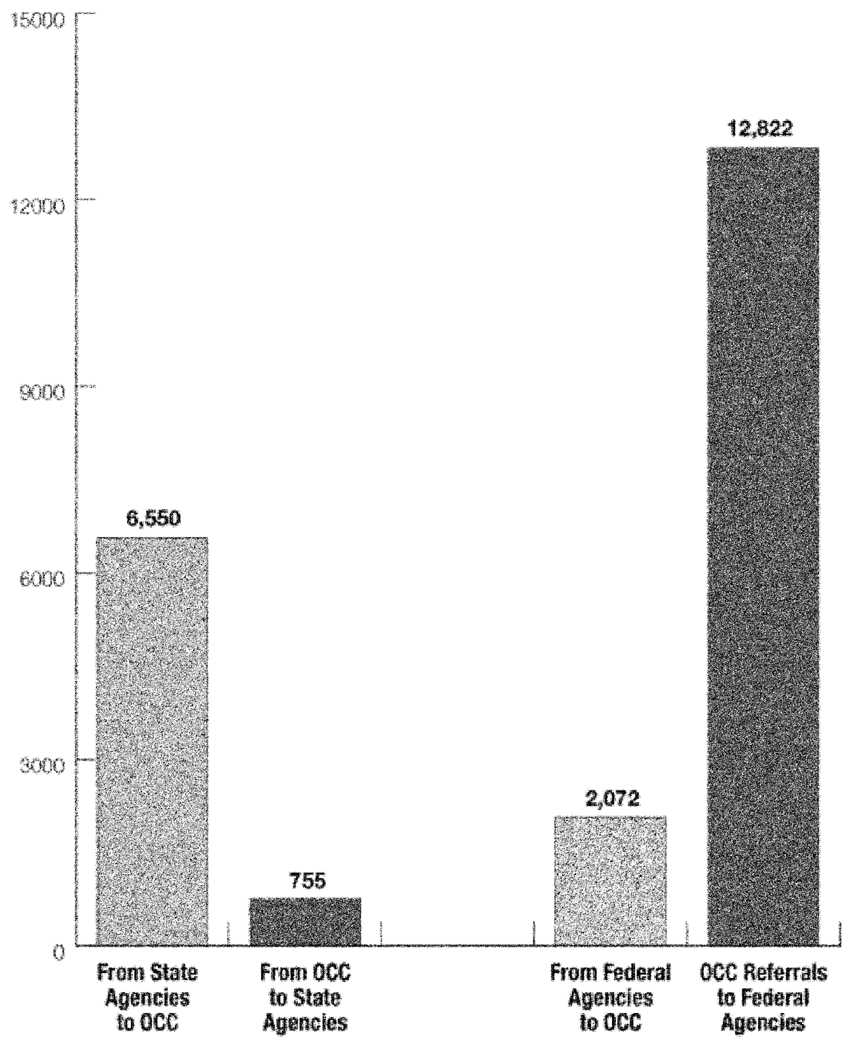
In conclusion, Mr. Chairman, we believe our new regulations provide benefits for national banks and protections for national bank customers and are entirely consistent with the fundamentals of the dual banking system. Our actions also are entirely consistent with Congress's design of the national banking system, the powers and authority Congress has vested in national banks, with legal precedent dating from the earliest years of the national banking system up to current times, and with the OCC's responsibilities to ensure not only the safety and soundness of national banks but also fair treatment of their customers.

Once again, thank you, Mr. Chairman, for this opportunity to present the OCC's views.

Comparison of OCC and State Examiner Resources



2003 Referrals of Consumer Complaints



TESTIMONY OF

ROY COOPER
ATTORNEY GENERAL OF NORTH CAROLINA

BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

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

APRIL 7, 2004

Introduction

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

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

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

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

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

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

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

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

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

The OCC's Preemption and Visitorial Powers Rules

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

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

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

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

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

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

THE OCC'S JUSTIFICATIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

Testimony of

GAVIN M. GEE

DIRECTOR OF FINANCE

For the

STATE OF IDAHO

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

Before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

April 7, 2004

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Importance of Decentralized Supervision

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

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

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

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

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

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

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

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

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

Dual Banking System and History of Preemption

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A New Class of Unregulated Institutions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

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

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

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

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

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

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

	Restitution received from national banks and/or national bank subs that the dept. investigated			Number of **investigations** Dept. conducted of mortgage companies, mortgage brokers, finance companies, title companies and other non depository institutions licensed by the Dept.		
	2003	**2002**	**2001**	**2003**	**2002**	**2001**
Alabama	N/A	N/A	N/A	N/A	N/A	N/A
Alaska	Unknown	Unknown	Unknown	10	8	9
Arizona	N/A	N/A	N/A	754	541	547
Arkansas	N/A	N/A	N/A	N/A	N/A	N/A
California	N/A	N/A	N/A	N/A	N/A	N/A
Colorado	Unknown	Unknown	Unknown	Approx. 400	Approx. 400	Approx. 400
Connecticut	157,712	191,995	138,700	667	930	864
Delaware	See footnote[1]	See footnote[1]	See footnote[1]	See footnote[2]	See footnote[2]	See footnote[2]
DC	0	0	0	12	3	0
Florida	Unknown	Unknown	Unknown	416	774	956
Georgia	NR	NR	NR	21	19	0
Hawaii	0	0	0	0	0	0
Idaho	0[3]	0[3]	0[3]	169	77	61
Illinois	Not tracked	Not tracked	Not tracked	75	Not tracked	Not tracked
Indiana	NR	NR	NR	772	674	869
Iowa	0	0	0	288	319	245
Kansas	See footnote[4]	0	0	152	100	115
Kentucky	0	0	0	1,121	1,079	1,030
Louisiana	Unavailable	Unavailable	Unavailable	78	8	3
Maine	10,000	8,000	8,000	524	485	400
Maryland	N/A	N/A	N/A	877	677	476
Massachusetts	N/A	N/A	N/A	441 (includes 104 visitations for mortgage rate lock issues)	785	589
Michigan	0	0	0	139	255	Not available

	Restitution received from national banks and/or national bank subs that the dept. investigated			Number of investigations Dept. conducted of mortgage companies, mortgage brokers, finance companies, title companies and other non depository institutions licensed by the Dept.		
	2003	2002	2001	2003	2002	2001
Minnesota	0	0	0	104	106	108
Mississippi	0	0	0	1,060	1,051	1,185
Missouri	0	0	0	360	345	355
Montana	0	0	0	1	3	2
Nebraska	Unknown	Unknown	Unknown	8	7	23
Nevada	See footnote[5]	See footnote[5]	See footnote[5]	Unknown	Unknown	Unknown
New Hampshire	0	0	0	12	0	0
New Jersey	6,761	7,163	270	1,291	1,215	1,237
New Mexico	Unknown	Unknown	Unknown	Not available	470	436
New York – (includes data on national bank affiliates)	42,520	102,174	706,307	991	844	859
North Carolina	Not tracked	Not tracked	Not tracked	178	205	231
North Dakota	0	0	0	0	0	0
Ohio	Unknown	Unknown	Unknown	853	844	1,019
Oklahoma	0	0	0	N/A	N/A	N/A
Oregon	Unknown	Unknown	Unknown	486	412	309
Pennsylvania	0	0	0	1,941	1,560	Unknown
Puerto Rico						
Rhode Island	0	0	0	279 – statutory examinations	204 – statutory examinations	N/A
South Carolina	Unknown	Unknown	Unknown	2,659	2,523	2,391
South Dakota	N/A	N/A	N/A	N/A	N/A	N/A
Tennessee (includes data on national bank affiliates)	121,859	1,404,065	N/A	2,698	2,023	584
Texas	0	Not available	Not available	502 – Texas S&L Dept. 78 – Texas Consumer Credit Commissioner	524 – Texas S&L Dept. 77 – Texas Consumer Credit Commissioner	370 – Texas S&L Dept. 83 – Texas Consumer Credit Commissioner

	Restitution received from national banks and/or national bank subs that the dept. investigated			**Number of investigations Dept. conducted of mortgage companies, mortgage brokers, finance companies, title companies and other non depository institutions licensed by the Dept.**		
	2003	**2002**	**2001**	**2003**	**2002**	**2001**
Utah	N/A	N/A	N/A	N/A	N/A	N/A
Vermont	N/A	N/A	N/A	12	11	14
Virgin Islands						
Virginia	Unknown[6]	Unknown[6]	Unknown[6]	781	660	758
Washington	Unknown	Unknown	Unknown	47	24	19
West Virginia	0	0	0	33 – examinations only, not official investigations	24 – examinations only, not official investigations	31 – examinations only, not official investigations
Wisconsin	10,486	17,170	32,044	2,393	2,398	2,029
Wyoming	0	0	0	22	31	44
Totals:	**349,338**	**1,730,567**	**885,321**	**23,705**	**22,695**	**18,651**

[1] Consumers who receive payments in connection with the resolution complaints usually receive those payments directly from the regulated institution. The Department's records do not show the total of such payments on an annual basis. The Department does not maintain records that show the amount of restitution made by national banks or their subsidiaries.

[2] The Department does not separately identify "investigations" as distinct from regular examinations or other procedures to resolve consumer complaints. The Department does not examine national banks, and the Department does not segregate information about licensees that may be national bank subsidiaries in a manner that would enable a response to this question.

[3] Idaho did not directly order restitution or fines against any national banks during these periods. The state does not gather information from all licensees regarding their status as a bank operating subsidiaries and therefore cannot break out amounts of restitution or fines based on this category. Furthermore, through the process of resolving consumer complaints against national banks and/or national bank operating subsidiaries, often restitution may have been received by consumers as a resolution to a complaint without an administrative action by the Department of Finance.

[4] Potential large refund in process (The Department recently did an exam at Wells Fargo Home Mortgage, Inc and they have tentatively agreed to refunds. However, they have also indicated they intend to allow their license to lapse due to the OCC preemption rule)

[5] The largest restitution issue was the joint state AG settlement with Household. Not sure what the total amount was in Nevada, but believe it was several million. Other fines were probably around $200,000.

[6] Once referral is made to the agency with supervisory jurisdiction, Virginia Bureau of Financial Institutions does not tract the outcome of the case.

	Number of enforcement actions Dept. took against national banks and/or national bank operating subsidiaries because the entity or entities were licensed by the Dept.			Number of licensees that have either already turned in their licenses due to the OCC's final rule or have stated that as of the rule's effective date they will no longer be licensed by the Dept.
	2003	2002	2001	
Alabama	N/A	N/A	N/A	N/A
Alaska	0	0	0	0
Arizona	N/A	N/A	N/A	N/A
Arkansas	N/A	N/A	N/A	N/A
California	N/A	N/A	N/A	N/A
Colorado	Unknown	Unknown	Unknown	65 (About 65 licenses turned in since 2001 when the OCC began issuing similar opinion letters.) Amerus Home Lending, inc.; Champion Mortgage Company, Inc; GN Mortgage Corporation; National City Mortgage; Altegra Credit Company; Citi Mortgage, Inc.; Chase Manhattan Mortgage; First Horizon Home Loan Corporation; Homeowners Loan Corporation
Connecticut	5	0	0	5 National City Mortgage; First Horizon Home Loan Corporation; Wachovia Mortgage Corporation; Citi Mortgage FNC; EAB Mortgage Company
Delaware	0	0	0	9 Bank of America Auto Finance; First Franklin Financial; National City Mortgage; Prosperity Mortgage Company; Wells Fargo Home Mortgage, Inc.; Wells Fargo Leasing Corporation; First Horizon Home Loan Corporation; PNC Mortgage Corporation
DC	0	0	0	22 CitiFinancial (13 offices); Wells Fargo (4 offices); GM Mortgage (1 office)
Florida	Unknown	Unknown	Unknown	Florida Statute Chapter 494 exempts wholly owned bank holding company subsidiary or a wholly owned savings and loan association holding company subsidiary that is approved or certified by the Department of Housing and Urban Development, the Veterans Administration, the Government National Mortgage Association, the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation.
Georgia	NR	NR	NR	This information is not tracked, but approximately 6-8 licensees have turned in their license due to the OCC's preemption and their eligibility to fall under that ruling.
Hawaii	0	0	0	None
Idaho	0[1]	0[1]	0[1]	3 Bank of America Specialty Finance, Inc.; Prudential Financial Home Mortgage, LLC; Financial Resources Mortgage, LLC
Illinois	0	1	0	8 First Horizon Home Loan Corporation; National City Mortgage Company; Wachovia Mortgage Corporation; Advanta Mortgage Corporation Midwest; Fleet Mortgage Corporation; Wells Fargo Home Mortgage, Inc.
Indiana	NR	NR	NR	None
Iowa	0	0	1	15 First Horizon Home Loan Corporation; Bethel Financial Group; Wells Fargo Home Mortgage; Edward Jones Mortgage; National City Mortgage Services; National City Mortgage; Altegra Credit Company; Homeowners Loan Corporation; CitiMortgage, Inc.; NationsBank Mortgage Corporation; BancPlus Mortgage Corporation; TCF Mortgage Corporation; First National Acceptance Corporation; Wachovia Mortgage Corporation

	Number of enforcement actions Dept. took against national banks and/or national bank operating subsidiaries because the entity or entities were licensed by the Dept.			Number of licensees that have either already turned in their licenses due to the OCC's final rule or have stated that as of the rule's effective date they will no longer be licensed by the Dept.
	2003	2002	2001	
Kansas	0	0	0	1 Wells Fargo Home Mortgage, Inc.
Kentucky	0	0	0	None
Louisiana	0	0	0	N/A
Maine	N/A	N/A	N/A	10 Wells Fargo Mortgage; HomeEq Servicing Corporation; Bank of America Specialty Finance; Banc One Mortgage Corporation; CitiMortgage; First Franklin Financial Corporation; Fleet Mortgage Corporation; The Huntington Mortgage Company; Fleetwood Credit Corporation d/b/a Banc of America RV Finance
Maryland	N/A	N/A	N/A	None
Massachusetts	N/A	N/A	N/A	None
Michigan	0	0	0	Less than 12
Minnesota	0	0	0	None
Mississippi	0	0	0	1 Wells Fargo Financial Services
Missouri	0	0	0	1 Wells Fargo
Montana	0	0	0	1 Wells Fargo Leasing Corporation d/b/a Wells Fargo auto Finance, Inc.
Nebraska	0	0	0	Already exempt in Nebraska
Nevada	Unknown	Unknown	Unknown	Unknown
New Hampshire	0	0	0	Unknown
New Jersey	0	0	0	NR
New Mexico	0	Not available	0	None
New York	2	0	0	None
North Carolina	0	0	0	None. However, please note that the MLA expressly exempts wholly owned subsidiaries of national banks and other depository institutions. Numerous subsidiaries of national banks are entitled to claim the exemption, and many have complied with the MLA's requirement that they file a written claim of such entitlement. Of these, some have filed the claim form with a letter stating that, because the MLA is generally preempted, the filing is a courtesy only.
North Dakota	0	0	0	
Ohio	0	0	0	None
Oklahoma	N/A	N/A	N/A	N/A – The Oklahoma State Banking Department does not regulate and/or license mortgage companies, mortgage brokers, finance companies, or title companies.

	Number of <u>enforcement actions</u> Dept. took against national banks and/or national bank operating subsidiaries because the entity or entities were <u>licensed by the Dept.</u>			Number of licensees that have either already <u>turned in their licenses due to the OCC's final rule</u> or have stated that as of the rule's effective date they will no longer be licensed by the Dept.
	2003	2002	2001	
Oregon	0	0	0	None
Pennsylvania	0	6	0	26
Puerto Rico				
Rhode Island	0	0	0	Data not compiled
South Carolina	Not available	Not available	Not available	
South Dakota	N/A	N/A	N/A	N/A
Tennessee	N/A	N/A	N/A	N/A
Texas	Not available	Not available	Not available	43 (Office of Consumer Credit Commissioner) Nations City Mortgage Company (25) ; Wells Fargo Home Mortgage, Inc. (18);
Utah	N/A	N/A	N/A	None
Vermont	N/A	N/A	N/A	12 Altegra Credit Company; Edward Jones Mortgage, LLC; Financial Resources Mortgage, LLC; Homeservices Lending, LLC; Prudential Financial Home Mortgage, LLC; Mutual Service Mortgage, LLC; First Horizon Home Loan Corporation; National City Mortgage Company; TriCom Mortgage, LLC; Wells Fargo Home Mortgage, Inc.; CitiMortgage, Inc.
Virgin Islands				
Virginia	0	0	0	None
Washington	0	0	0	3 National City Mortgage; First Horizon; Wells Fargo Home Mortgage
West Virginia	0	0	0	National City surrendered its licenses, but after some letter writing, it renewed for 2004 Huntington National Bank has sent a letter stating it will no longer reply to requests for asset and deposit information because of the OCC ruling; however it has no mortgage licensees in WV.
Wisconsin	0	0	0	1 Wells Fargo Leasing Corporation d/b/a Wells Fargo Auto Finance
Wyoming	0	0	0	1 Wells Fargo Auto Finance, Inc.
Totals:	**7**	**7**	**1**	

[1] Idaho Department of Finance did not take any enforcement action against a national bank during this period. However, the state does not gather information from all licensees regarding their status as a bank operating subsidiaries; therefore it cannot report the number of actions taken against national bank operating subsidiaries.

ATTACHMENTS:

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

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

Connecticut

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

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

The complaints were against the following companies:

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

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

New York

Citifinancial

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

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

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

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

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

ABN Ambro

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

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

Maine

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

Title 9-A

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

National Bank Finance Company Subsidiary - Repossession without proper notice.

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

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

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

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

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

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

National Bank Mortgage Company Subsidiary - Inaccurate payoff calculation.

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

Tennessee

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

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

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

Wisconsin

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

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

Examples of Complaints Against National Banks or Their Subsidiaries (State of Wisconsin)

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

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

Testimony of Martin Eakes,

Chief Executive Officer, Center for Responsible Lending

Before the Senate Committee on Banking, Housing and Urban Affairs

Hearing On

The Office of the Comptroller of the Currency's Rules on

National Bank Preemption and Visitorial Powers

April 7, 2004

Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, thank you for holding this important hearing and for inviting me to testify before you today. I am CEO of Self-Help and the Center for Responsible Lending (CRL). Self-Help is a non-profit community development lender that creates ownership opportunities for low-income and minority families through homeownership and small business financing. Since 1980, Self-Help has provided over $3 billion in financing in 47 states, enabling more than 37,000 families to become homeowners. CRL, an affiliate of Self-Help, is a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL is dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

For the first 20 years of my professional life, I worked to make subprime home loans to low-wealth families unable to get a loan from a bank. In 1998, my perspective on Self-Help's mission expanded when a middle-aged African American home loan borrower broke into tears in my office. He told me his wife had died three years before, leaving him to care for their six-year old daughter. He desperately wanted to hold onto his house, telling me, "This house is more than a home. It is also the physical memory of my daughter's mother." For ten years, he said, he had tried to refinance a home loan he had taken at 14% interest; he insisted that the lender would not let him pay off the loan. The loan documents showed that this man's loan of $29,000 had been inflated with $15,000 in fees. The lender would not tell him—or me -- the pay-off balance.

We soon discovered that the problem was larger than one loan. This same lender was making 18,000 mortgage loans per year in North Carolina alone. As I attempted to help this man refinance his loan with Self-Help—and to help others who followed him -- I learned how an unscrupulous lender can steal a lifetime's accumulation of wealth in the few seconds it takes a homeowner to sign his name. We realized all our efforts to build wealth through homeownership are unlikely to result in lasting changes for the communities we work in unless we also work to protect wealth from predatory practices and unscrupulous lenders.

States have acted to build on federal protections against abusive lending; however, the OCC's final regulation represents a major step backwards in the fight against predatory lending. We cannot afford to have our collective efforts to protect borrowers from losing their homes and the lifetime of savings built up in home equity to be diminished by a renegade federal agency. To preserve homeownership, a competitive dual banking system, and the right of states to protect their citizens, Congress should rescind the OCC's regulation.

In my testimony, I will emphasize four main points:

- First, the OCC's final regulation rolls back state legislation that has curbed abusive lending practices while preserving access to credit. The OCC's action will undermine creative efforts by states to protect their citizens from evolving financial abuses.
- Second, the OCC's final regulation has all but eliminated the essential role that States have played in enforcing state laws against abusive lending by national banks, and particularly, by their operating subsidiaries. Instead of complementing a state's efforts, the OCC seeks to replace them, at a catastrophic cost to American homeowners.
- Third, the OCC has blatantly ignored Congressional directives to refrain from interfering with state efforts to protect its citizens from abusive lending unless the Federal policy interest is clear and the legal basis is compelling.
- Finally, the OCC's actions will make the national bank charter a safe haven for predatory lenders, an outcome that is bad for borrowers and bad for banks.

I. State laws have effectively curbed abusive lending without drying up access to credit.

Predatory lending practices, such as exorbitant and anti-competitive fees, strip families of the home equity wealth that could otherwise be used to send children to college, start small businesses, weather crises such as unanticipated medical expenses, and ensure a measure of economic security in old age. We estimate that predatory lending costs American families approximately $9.1 billion each year in lost homeowner equity, unfair back-end penalties, and excess interest paid.[1]

A. State legislatures have devised successful approaches to the problems of predatory lending.

Five years ago, we helped form the Coalition for Responsible Lending to respond to predatory lending in North Carolina. The group began with the CEOs of 120 financial institutions. Eighty-eight organizations joined this coalition, representing three million North Carolina voters. Coalition members included the NAACP, Habitat for Humanity chapters, and the Council of Churches. Ultimately, the Coalition worked with associations representing realtors, mortgage brokers, mortgage bankers, credit unions, community banks, and the state's large banks to support a moderate bill that passed both legislative chambers nearly unanimously.

Significantly, national banks – and North Carolina has some of the largest and best -- helped draft North Carolina's landmark law and publicly supported it. Their participation in the state effort reinforced what we already knew from our lending partnerships: The vast majority of national banks are responsible lenders and they abhor predatory lending, both for creating a negative perception of financial institutions and as an illegitimate and anti-competitive banking practice. Consequently, I was surprised to hear the OCC's Chief Counsel assert in January that some national banks had stopped making subprime home loans in North Carolina because of the law. To my knowledge, not a single national bank has complained about North Carolina's law or has ever

[1] Stein, Eric. "Quantifying the Economic Cost of Predatory Lending," Coalition for Responsible Lending

requested that the OCC issue a ruling to preempt the law's application. In fact, no major prime or subprime lender has pulled out of the North Carolina mortgage market in response to the law that has been in full effect since 2000.

North Carolina's predatory lending law was built on the foundation of the federal Home Ownership and Equity Protection Act of 1994. We did not ban specific loans. Rather, building on the HOEPA model established by Congress, the North Carolina predatory lending law established special protections for borrowers entering into "high-cost" loans. North Carolina did not alter the federal HOEPA standard on interest rates in any way because we felt the major abuses were exorbitant fees and other equity-stripping loan terms. Once charged, fees are forever; excessive interest rates, on the other hand, can be temporary, as responsible lenders compete to offer better rates. Thus, the North Carolina law supplemented federal protections by reducing the threshold for up-front fees that trigger high-cost loan protections. The law therefore encourages – but does not require -- lenders to shift some compensation from upfront fees to interest rates, so that the risk of a loan is captured in the rate, the term most apparent to borrowers shopping for a loan.

Reflecting the broad consensus we developed in North Carolina, the law lowered the threshold for additional borrower protections to five percent of the loan amount—five times the fees typically charged in the conventional market.[2] This threshold is still generous, and the law does not apply protections to the vast majority of prime or even subprime loans. Rather, it adds important protections for the worst and most risky loans

(2001) (available at http://www.predatory lending.org/pdfs/Quant10-01.PDF).
[2] According to Freddie Mac, conventional borrowers pay, on average, a 1.1% origination fee. Fannie Mae conference, "The Role of Automated Underwriting in Expanding Minority Home Ownership," Airlie

in the marketplace, loans that should be rare. The vast majority of national banks do not even make loans in this range. In fact, Fannie Mae and Freddie Mac, as well as many other lenders' and investors' best practices, currently provide that they will not make or purchase loans with points and fees above five percent of the loan amount.[3] The OCC itself has cautioned national banks against the liquidity risk of investing in mortgages with more than 5% points and fees given the adverse reaction from the secondary market to those loans.[4]

In addition to providing protections for borrowers in high-cost home loans,[5] the North Carolina law also prohibits a few blatantly abusive practices for all home loans. In particular, the law bans the financing of single premium credit insurance, insurance purchased by the borrower to repay the lender in the event the borrower dies. The practice of financing credit insurance into a home mortgage has been almost completely eliminated since the passage of the North Carolina law, through the combined efforts of

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Center, Warrenton, Virginia, (June 8, 2000). Peter Mahoney, Associate General Counsel of Freddie Mac, reported that total points and fees for conventional loans has decreased from 1.6% in 1993 to 1.1% in 1999.

[3] Freddie Mac and Fannie Mae, the two largest purchasers of home loans in the nation, will not purchase home loans with points and fees in excess of 5%.http://www.freddiemac.com/sell/selbultn/1228indltr.html; http://www.efanniemae.com/singlefamily/forms_guidelines/lender_letters/db_lender_letters.jhtml?role=ou#03-00). In addition, the best practices of the nation's three largest subprime home lenders, accounting for more than 25% of the market, limit fees on loans to 5% or less: Household International, the nation's largest subprime home lender, caps origination fees at 3%. *See* http://www.household.com/corp/hiau_best_practice.jsp#5. Citifinancial, the nation's second largest subprime home lender, caps fees on loans made at Citi branches at 3%. *See* 9/19/2002 announcement at http://www.citigroup.com/citigroup/press/data/020919a.htm. Washington Mutual, the nation's third largest subprime lender, caps points and fees at 5% (including yield spread premiums paid by lender to brokers). *See* http://www.wamunewsroom.com/images/pressreleases/Responsible_lending_principles.pdf.

[4] OCC Advisory Letter 2003-3 (http://www.occ.treas.gov/ftp/advisory/2003-3.doc).

[5] Because financed fees are often invisible to the borrower, who does not actually see cash paid out for these costs, lenders may not finance fees in high-cost loans. The law also prohibits balloon payments and negative amortization on such loans, loan structures that can be used to obscure the cost of equity-stripping fees. Furthermore, high-cost home lenders must look beyond the value of the collateral used to secure a loan when assessing borrowers' ability to repay. Finally, given the high likelihood of abuse in high-cost home loan transaction, the law requires counseling before a high-cost loan is closed. This mandate is similar to the Congressional requirement of counseling in conjunction with reverse mortgage transactions.

federal regulators,[6] the GSEs,[7] and disavowal of the practice by major lenders.[8] The Act also bans "flipping," refinancing a loan primarily to generate fees for the lender without providing the borrower with a "reasonable tangible net benefit." Prepayment penalties for early repayment of a first-lien home loan of less than $150,000 -- deceptive fees pervasive in the subprime market[9]-- are also not permitted. Again, these are practices that an increasing number of lenders have disavowed. By CRL's estimate, the North Carolina anti-predatory lending law saves homeowners $100 million each year.[10]

Fortunately, North Carolina has not been the only State to pass important legislation against predatory lending. Nearly half of the States have passed legislation to curb abusive lending. Much has been learned through these efforts. In Georgia, for instance, the legislature passed the strongest anti-predatory lending law in the country,

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[6] 66 Fed. Reg. 65604 (Dec. 20, 2001) (amending Regulation Z to include premiums for credit life insurance and similar products in the calculation of the HOEPA points and fees trigger).

[7] *See* Freddie Mac, "News Release: Freddie Mac Announces Steps To Protect Borrowers From Predatory Lending Practices" (March 24, 2000) (available at http://www.freddiemac.com/news/archives2000/predatory.htm).; Fannie Mae, "News Release: Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices" (April 11, 2000) (*available at* http://www.fanniemae.com/newsreleases/2000/0710.jhtml).

[8] Bank of America, Chase, First Union, Wachovia, Ameriquest, Option One, Citigroup, Household and American General have all decided not to offer SPCI on their subprime loans. See "Equicredit to Stop Selling Single-Premium Credit Life", *Inside B&C Lending* at p.3 (Bank of America, April 2, 2001); Erick Bergquist, "Gloom Turns to Optimism in the Subprime Business," *American Banker* at p.10 (Chase, May 15, 2001); "First Union and Wachovia Announce Community Commitment for the New Wachovia," (May 24, 2001); statements by officers of Ameriquest and Option One; Jathon Sapsford, "Citigroup Will Halt Home-Loan Product Criticized by Some as Predatory Lending," *Wall Street Journal* (June 29, 2001); Anitha Reddy, "Household Alters Loan Policy," *Washington Post* (July 12, 2001); Patrick McGeehan, "Third Insurer to Stop Selling Single-Premium Credit Life Policies", *New York Times* (American General, July 21, 2001).

[9] In contrast to an 80% prevalence of prepayment penalties in subprime loans, in the competitive, conventional conforming market, less than 2% of borrowers accept prepayment penalties. *See* Standard & Poor's, *Legal Criteria Reaffirmed for the Securitization of Prepayment Penalties, at* http://www.standardandpoors.com (May 29, 2002); *Freddie offers a new A-, prepay-penalty program*, Mortgage Marketplace, at 1-2 (May 24, 1999); Joshua Brockman, *Fannie revamps prepayment-penalty bonds*, American Banker at 16 (July 20, 1999). For a discussion of prepayment penalties, *see* Goldstein and Son, *Why Prepayment Penalties are Abusive in Subprime Loans* (April 2, 2003) (*available at* http://www.responsiblelending.org/pdfs/PPP_Policy_Paper2.pdf).

[10] Ernst, Keith, John Farris, and Eric Stein, "North Carolina's Subprime Home Loan Market After Predatory Lending Reform", Center for Responsible Lending (August 2002) (available at http://www.responsiblelending.org/predlend_nc/working.cfm).

only to realize that its strict liability for buyers of home loans unnecessarily restricted the willingness of secondary market participants to provide credit to Georgia homeowners. In a matter of days, secondary market players and Georgia policymakers were able to draft language to address this problem. Georgia taught us an important lesson: State legislatures can move with rapid speed to fine-tune the balance between protecting access to credit and protecting borrowers from abusive loan terms.

Furthermore, states can build on the successes of other states to fill in gaps left in earlier laws. In fact, after numerous other states applied their anti-predatory lending laws to open-end loans, North Carolina expanded its law to cover these loans under our Act. Most recently, legislatures in New Jersey and New Mexico have passed strong anti-predatory lending laws that have incorporated the successful parts of the "first generation" of predatory lending laws (such as New York and North Carolina), adopted the lessons of Georgia's experience, and added new provisions to close loopholes that have emerged in these earlier laws.

All of the major secondary market participants, including Fannie Mae and Freddie Mac, have recently announced that they will continue to purchase or rate all mortgage transactions in New Jersey and New Mexico, with the exception of high-cost loans.[11] In

[11] See, e.g., Fannie Mae, *Purchase of New Jersey and New Mexico "High-Cost Home Loans," and Illinois "High-Cost Home Loans,"* Announcement 3-12 (November 21, 2003); Freddie Mac, *Industry Letter* (November 26, 2003); Standard & Poors, *Standard & Poor's Permits Additional New Jersey Mortgage Loans Into Rated SF Transactions* (November 25, 2003) (specifically citing NJ Department of Banking regulations and an opinion from the NJ Attorney General as reasons for their policy adjustment). While there have been some technical concerns raised with regard to the New Jersey and New Mexico laws, legislators and regulators in those states have again proven that they can readily resolve such issues. See, e.g. Bulletins 3-30 and 3-15 regarding the New Jersey Homeownership Security Act, *available at* http://www.njdobi.org/PressReleases/pr111803.htm. While there have been some claims that lenders are leaving the New Jersey market, this appears to be politically motivated, rather than based on substantive concerns with the law. The Department of Banking recently stated,
Unfortunately, certain large lenders are trying to stop the new law by refusing to offer loans, refusing to fund smaller lenders, and arguing that the law will dry up available credit. It is not the law that is drying up

fact, there continues to be a thriving secondary market for the vast majority of subprime loans in states that have enacted anti-predatory lending legislation. Nationally, both subprime lending and the securitization of subprime loans increased by over 50 percent in 2003 over 2002 – volume increased to $332 billion from $213 billion, while subprime securities rose to $203 billion from $135 billion.[12] As reported by an industry publication, "Subprime lenders should continue to see strong demand for their product in the secondary market this year, analysts predict."[13] Furthermore, "Fitch anticipates few problems from 'pending or existing' predatory lending laws, as both sellers and issuers have significantly stepped up their due diligence efforts."[14]

The adjustments by secondary market participants demonstrate that state laws successfully encourage the market to police itself and discourage loans with excessive fees. Because the secondary market is willing to purchase all loans except high-cost loans, lenders are more likely to charge for risk through rate in order to stay below high-cost thresholds. Further, these laws ensure that borrowers with high-cost loans are better protected if a loan turns out to be abusive, because the lender is more likely to have held the loan in portfolio.

In summary, state legislatures have acted as laboratories of democracy. These efforts are producing a convergence on many issues and have already had an effect at the federal level. State efforts have informed the Federal Reserve's decision to include single

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credit, it is these steps lenders are taking as part of their overall strategy to change the law. *Available at* http://www.state.nj.us/dobi/hoa03alert.htm.

[12] Inside B & C Lending. Jan. 12, 2004, p.3 and Feb. 9, p.1. The growth rate over ten years has been astounding: in 1994, subprime lending totaled just $34 billion, while only $11 billion of that was securitized.

[13] Inside B & C Lending. Jan. 12, 2004, p.3.

[14] Id. at 4.

premium credit insurance in the HOEPA calculation of points and fees,[15] the OTS decision to address prepayment penalty abuses by state housing creditors,[16] and even the OCC's own advisory guidance regarding unfair and deceptive trade practices.[17]

B. State laws are working as intended, notwithstanding the OCC's efforts to impugn them with rhetoric and flawed research.

Unfortunately, the OCC has attacked state anti-predatory lending laws in order to justify its preemption rules. We believe that, had it had been a bit more vigorous in its own empirical assessment of these laws, the OCC would have concluded that the North Carolina law has decreased predatory practices without diminishing access to legitimate credit and that other state laws were likely to have similar results.

When it promulgated its proposed rule and preempted application of Georgia's amended law to national banks, the OCC released a working paper entitled "Economic Issues in Predatory Lending" in July 2003. This outcome-driven working paper falls far short of the quality of research one would expect from a federal agency. The working paper shows an underlying failure to understand the real abuses addressed by the state anti-predatory lending laws. The best example of the OCC's blinders can be seen in the paper's focus on interest rates; the paper fails to consider excessive fees or equity-stripping practices like flipping. This oversight is astonishing since successful state anti-predatory lending laws all target excessive fees, not interest rates. Furthermore, as explained in CRL's comments to the OCC on this working paper, the OCC demonstrates

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[15] 66 Fed. Reg. 65604 (Dec. 20, 2001).
[16] 67 Fed. Reg. 60542 (Sept. 26, 2002).
[17] *See* OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 21, 2003; OCC Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 21, 2003.

significant bias in its review of research conducted on the impact of anti-predatory lending laws.[18]

1. Research shows that the North Carolina law is working as intended to protect homeowners and preserve access to credit.

The best and most comprehensive research regarding the effects of the North Carolina law shows that the North Carolina approach has been successful in addressing the worst predatory lending abuses while preserving access to affordable credit for subprime borrowers. Using a database of 3.3 million loans made by more than twenty lenders in all fifty states, researchers at the Center for Community Capitalism at the Kenan-Flagler Business School of the University of North Carolina at Chapel Hill concluded that the law is working as intended.[19] After analyzing the effects of North Carolina's law on the home mortgage market, the researchers found that the data "are strongly suggestive that the North Carolina law is doing what it is supposed to do."[20]

While the number of subprime refinance originations decreased after the law's implementation, "about ninety percent of the decline was in predatory loans."[21] More specifically, the UNC study noted a decline in the incidence of subprime home refinance loans containing prepayment penalty terms that exceed three years, subprime balloon payments, and loan-to-value ratios of 110 percent or more. The study appropriately viewed such loans as of little or no benefit to the borrower. In short, the study suggests

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[18] See Center for Responsible Lending, *Comments Addressing the OCC's Proposal to Preempt Application of State Anti-Predatory Lending and Other Laws,* Docket No. 03-16, October 6, 2003, at Appendix A. CRL comments to the OCC are available on our website at http://www.responsiblelending.org.
[19] The Loan Performance data set used for this study is the most comprehensive data available on the subprime mortgage market. R. Quercia, M. Stegman, & W. Davis, "An Assessment of the Impacts of North Carolina's Predatory Lending Law" (forthcoming Fannie Mae Foundation Housing Policy Debate). Note: As acknowledged in the study, the Center for Responsible Lending provided financial support to enable the research.
[20] R. Quercia, et al. at 26.

that the reduction of subprime refinances is consistent with a "weeding out" of bad loans since passage of the law.

Results from the study also suggested that the fees being charged before the law's implementation were not genuinely priced to account for the risk of default, but rather were inflated to extract extra charges from North Carolina's most vulnerable populations. The aim of the North Carolina law was to encourage lenders to reflect price in interest rate rather than in fees. However, "the mean change in interest rate for all subprime originations in North Carolina after the law took effect is significantly lower than the national increase."[22] This fact also suggests that there was no post-law reduction in the supply of capital to North Carolina.

In fact, on the crucial issue of credit availability, the report found that "Home purchase loans to North Carolina borrowers with credit scores below 580 more than doubled since the Act was fully implemented, compared with a 62 percent increase nationally."[23] In addition, "**there was a post-law growth of 72 percent in the number of subprime home purchase loans in North Carolina**."[24]

The University of North Carolina confirmed what earlier research already suggested. An analysis by a leading industry trade journal, Inside B&C Lending, found that top North Carolina subprime lenders continue to offer a full array of products for borrowers in North Carolina—with little or no variation in rate compared to other states.[25] In addition, a Morgan Stanley & Co. survey of 280 subprime branch managers

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[21] R. Quercia, et al. at 26.
[22] R. Quercia, et al. at 22.
[23] R. Quercia, et al. at 20.
[24] R. Quercia, et al. at 18.
[25] Inside B&C Lending. 2001. Lenders Will Try to Pin Down Effects of NC Mortgage Law. March 5.

and brokers found that tougher predatory lending laws have not reduced subprime residential lending volumes in any significant way.[26]

Our own analysis of home loans reported to federal regulators as originated under the Home Mortgage Disclosure Act (HMDA) shows that subprime lending continues to thrive in North Carolina.[27] In 2000, North Carolina was still the sixth most active state for subprime lending, with North Carolina borrowers 20 percent more likely to receive a subprime loan than borrowers in the rest of the nation. One in every three loans to low-income North Carolina families (annual incomes of $25,000 or less) was subprime, the highest such proportion in the country.

2. The OCC ignored this compelling research in favor of uncritical acceptance of flawed research that supported the OCC's position.

The OCC working paper, however, uncritically accepted the conclusions of an industry-sponsored Credit Research Center (CRC) study, which claimed that the North Carolina law decreased low-income borrowers' access to credit. The CRC's conclusions should be viewed with suspicion for several reasons. First, the CRC study contradicts other industry reports and the weight of available evidence. Second, the CRC study relies upon a limited data set from nine anonymous lenders that has not been made available for independent verification.[28] Third, the CRC study examines data from a period ending June 30, 2000, the day before most of the North Carolina law's provisions took effect.

[26] Morgan Stanley. 2002. Channel Check: Surprisingly Strong Subprime Growth. Diversified Financials. August 1.
[27] Ernst, Keith, John Farris, and Eric Stein, "North Carolina's Subprime Home Loan Market After Predatory Lending Reform", Center for Responsible Lending (August 2002) (available at http://www.responsiblelending.org/predlend_nc/working.cfm).
[28] The CRC study started with a pool of 1.4 million loans made by nine anonymous members of an industry trade group (that funds CRC) in four states chosen by the authors. The researchers then analyzed one-tenth of these loans. By contrast, the UNC study analyzed 3.3 million loans made by more than twenty lenders in

Moreover, the data omits all open-end home loans from those lenders and is unable to account for a possible shift in lending to other lenders from one of the anonymous nine lenders studied. Finally, the CRC study ignores the problem of "flipping" and consequently assumes that any reduction in subprime originations is evidence of harm. However, any successful anti-predatory lending law would curb the practice of flipping (refinancing loans with no benefit to the borrowers) and thus would tend to reduce the number of subprime refinance originations.

The loan I discussed at the beginning of my testimony illustrates the difference between the OCC's perspective and that of researchers from the University of North Carolina. The OCC and Credit Research Center view any drop in the number of subprime loans originated as evidence of a problem in the law, ignoring the fact that the intention of the law was to prevent abusive loans from being made. In many of the cases of predatory lending we have seen, the borrowers would have been better off if they had not refinanced their existing loan, but had pursued other options, such as a second mortgage. In many other cases, the borrowers could have obtained a better-priced loan, one that did not strip hard-earned equity from their home.

Those who claim that North Carolina has a liquidity crisis because of our anti-predatory lending laws are far divorced from the North Carolina mortgage market. Those who live and work in the state know that loans remain widely available. Joseph Smith, North Carolina's Commissioner of Banks, has commented that "[d]uring the last twelve months, over seventy-five percent of formal complaints to [his office] … have involved mortgage lending activities [but] …. [n]ot one of these complaints has involved the

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all fifty states. The Loan Performance data set used for the UNC study is the most comprehensive data available on the subprime mortgage market.

inability of a North Carolina citizen to obtain residential mortgage credit."[29] In a recent report to our Governor Michael Easley, Commissioner Smith stated,

> As you may know, it has been alleged that North Carolina's predatory lending law and the Mortgage Lending Act have resulted in the denial of credit to sub-prime borrowers. I believe the facts do not support that allegation…Complaints I have received and recent trends in real estate foreclosures suggest, to the contrary, that our citizens have received all of the credit of this kind that they need – and more.[30]

While the OCC may find it convenient to criticize state anti-predatory lending laws, the OCC lacks any factual foundation for its claims that the laws increase the cost of credit or that they interfere with the legitimate exercise of national banks' powers. The laws that the OCC wants to displace are working to protect homeowners and to preserve access to credit.

3. <u>The OCC's actions interfere with state efforts to address abusive practices</u>.

Unfortunately, the OCC's actions have already interfered with state efforts to address abusive practices by forcing state officials to choose between protecting consumers and disadvantaging state financial institutions. While the state of Tennessee has been considering enactment of protections against abusive lending practices, state officials now are reluctant to take action, even as applied to state-regulated finance companies. The Commissioner of Tennessee's Financial Institutions Department, for example, recently predicted that state-regulated entities such as mortgage lenders are now likely to affiliate with national banking institutions to take advantage of the OCC's new

[29] North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. letter to Comptroller John D. Hawke, Jr. (October 2, 2003) (*available at* http://www.banking.state.nc.us/reports/Hawke.pdf).

preemption rules, and expressed discomfort with passing a law that the state could not enforce.[31]

State officials will rarely expend great effort to enact a law that cannot be enforced or that will put the state's financial institutions at a competitive disadvantage. The chilling effect that the OCC's final action is having on state legislatures is unfortunate, since states are the most appropriate entities to protect consumers within their borders. New financial services products are developed every day, and new scams and unfair practices are among them. The federal government is too far removed to keep up with unscrupulous lenders' new tactics to exploit the unwary, but state governments can act quickly as new predatory practices arise. Furthermore, predatory lending can affect whole neighborhoods, as foreclosures brought on by abusive loans diminish nearby property values and discourage the growth of local businesses. States need to have the ability to respond when waves of foreclosures threaten to destroy communities.

II. State enforcement efforts are crucial in protecting homeowners from predatory lending by national banks or, especially, by national banks' operating subsidiaries.

A law – or a regulation -- is only effective when enforced. The North Carolina law has been successful in part because it has been accompanied by strong enforcement by our state's officials. Both our Attorney General and Commissioner of Banks have been active in investigating and taking action against abusive practices in the state and have been outspoken in their support of the law as an effective protection for consumers.

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[30] North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. *Mortgage Lending Act Report,* via letter to Gov. Michael Easley (September 23, 2003) (*available at* http://www.banking.state.nc.us/reports/mla report.pdf).

North Carolina was the first state in the nation to pursue claims against the Associates, investigating allegations of the illegal packing of single premium credit insurance in mortgage loans as early as July 1999, and eventually recovering approximately $20 million for over 11,000 North Carolina homeowners in 2001.[32] This important action, like state legislative efforts, has helped to inform federal enforcement. The FTC soon followed the lead of the state Attorneys General and filed its own suit, winning $215 million for consumers nationwide a year later.[33]

North Carolina is not alone. In the largest predatory lending case in history, the state Attorneys General of the 50 States recovered $484 million in restitution to homeowners subjected to abusive lending practices – as defined under state law -- by Household Finance. States have well-established consumer protection departments that have a proven track record in fighting to protect their citizens from predatory lending abuse.

Instead of complementing these efforts to protect homeowners, the OCC's final rule displaces them. In her January testimony, Chief Counsel Williams suggested that States should reallocate resources from enforcing laws against financial abuses to other areas of consumer protection. Based on this position, the OCC has a special obligation to produce compelling evidence that it is better equipped than states to protect homeowners across the country from abusive lending practices. While I appreciate any enforcement

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[31] Karin Miller, "Federal Rule Usurps State Effort to Regulate Predatory Lending," Associated Press Newswires, January 20, 2004.

[32] Office of the Attorney General, State of North Carolina, News Release: *Associates $20.2 million consumer settlement is largest in NC history* (Sept. 16, 2002) (*available at* http://www.jus.state.nc.us/).

[33] Federal Trade Commission, News Release, *Citigroup Settles FTC Charges Against the Associates Record-Setting $215 Million for Subprime Lending Victims* (Sept. 19, 2002) (*available at* http://www.ftc.gov/opa/2002/09/associates.htm).

efforts to curb predatory lending by the OCC, or by anyone else for that matter, the OCC falls far short of the current state enforcement system.

First, in contrast to the mission of State officials, the OCC's primary mission is to serve banks rather than individual homeowners. The OCC defines its mission as "ensur[ing] a stable and competitive national banking system."[34] For the OCC, protecting the banking system comes first, and protecting homeowners from predatory lending is, at best, a result of the efforts to keep the national banking system operating well. In fact, as it points out in its own rule, the OCC does not even have the authority to devise rules under the primary consumer protection statute it can enforce, the FTC Act; rulemaking authority belongs to the Federal Reserve.[35] Congress did not create the OCC to protect borrowers.

Second, it is unclear that the OCC has proper incentives in place to aggressively protect homeowners from predatory lending abuse. The national banks fund the OCC through assessments and fees for special services. The OCC's proposed rule is widely viewed as designed to help the largest national banks, which conduct business in many states and also happen to pay the largest assessments to the OCC. In fact, for several years the OCC has aggressively pursued a strategy of making preemption of state laws a major benefit of the national bank charter. In a speech delivered on February 12, 2002,[36] Comptroller of the Currency John D. Hawke, Jr., argued, "There is no question that

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[34] It's worth noting that in the hierarchy of the OCC's objectives, borrower protection merits, at best, a fourth place, behind: 1) To ensure the safety and soundness of the national banking system; 2) To foster competition by allowing banks to offer new products and services; and 3) To improve the efficiency and effectiveness of OCC supervision, including reducing regulatory burden. *See http://www.occ.treas.gov/aboutocc.htm.*

[35] 69 Fed. Reg. 1904, 1911 (Jan. 13, 2004).

[36] The speech was reprinted in OCC News Release 2002-10.

national banks' immunity from many state laws is a significant benefit of the national charter—a benefit that the OCC has fought hard over the years to preserve."

The OCC's need to maintain the support of national banks creates an inherent conflict of interest with its ability to protect homeowners. In a case involving preemption of a Texas consumer protection statute, the Fifth Circuit Court of Appeals recognized this conflict, noting: "[T]he constituency positively affected by the OCC's position [of preemption] is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded."[37]

Third, beyond a question of mission or motive, the OCC simply has not demonstrated an ability to resolve claims of abusive mortgage lending comparable to state officials'. While the OCC trumpets its "pioneering actions using the FTC Act to address consumer abuses,"[38] the only case involving home mortgage abuses the OCC cites is one in which it obtained $100,000 in restitution for 30 homeowners.[39] According to Helen P. Howell, the Director of the Department of Financial Institutions in the State of Washington, "[I]n 2002 alone, the states recovered over $500 million in restitution and fines for predatory lending and other consumer protection violations, compared to only $7 million collected by the OCC.[40] Unlike other regulators, including the Department of Housing and Urban Development, the Department of the Treasury, and the Federal Reserve Board, the OCC has never even held a public hearing on predatory lending concerns, despite repeated requests from consumer advocates.

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[37] Wells Fargo Bank of Texas v. James, 321 F.3d 488, 494 (5th Cir. 2003) (deferring to OCC's preemption of Texas consumer protection statute regarding charges on cashing paychecks)
[38] 69 Fed. Reg. 1904, 1913 (Jan. 13, 2004).
[39] Id. The vast majority of OCC enforcement actions have focused on credit card abuses.

The case involving Guaranty National Bank of Tallahassee ("Guaranty National Bank") shows that championing the rights of consumers is not the OCC's priority. Guaranty National Bank engaged in a rent-a-charter scheme that allowed other lenders to make abusive loans in its name. Thousands of borrowers were charged double-digit points, including bogus discount points that did not in fact result in a reduction in the interest rate.[41] While an OCC examination agreement places tight restrictions on Guaranty National Bank's lending activities and collected a $25,000 penalty, the OCC apparently did not order any consumer restitution.[42] While the bank was finally closed earlier this month,[43] redress for consumers came only through private enforcement of state consumer protection laws, where a recent settlement provided $41 million to the bank's borrowers.

The OCC's staffing and structure also pale in comparison to the resources of state consumer protection divisions and state banking departments. The OCC simply does not have the staff to replace state enforcement personnel. To put it in perspective, Director Helen Howell pointed out that,

> The OCC has indicated that it will rely on an otherwise fully engaged staff of national bank examiners and a limited staff of OCC employees (fewer than 50 in a Customer Assistance Group) to respond to complaints from consumers nationwide. By contrast, however, in just 3 of

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[40] Letter from Helen P. Howell to John D. Hawke, Jr. (October 3, 2003).

[41] See, e.g., First Amended Complaint, Baxter v. Guaranty National Bank of Tallahassee and Chase Manhattan Bank, 01-CVS-009168 (N.C.Sup. Sept. 4, 2001); see also Complaint in Class Action, Ulrich v. Guaranty National Bank of Tallahassee and GMAC-Residential Funding Corporation, 02-1616 (W.D. Penn. 2002).

[42] See Agreement by and between Guaranty National Bank Tallahassee, Florida and the Office of the Comptroller of the Currency, Formal Agreement No. 2002-2 (January 25, 2002), available at http://www.occ.treas.gov/FTP/eas/ea2002-2.pdf. See also Consent Order, U.S. Dept. of Treasury, Office of the Comptroller of the Currency, In the Matter of Guaranty National Bank of Tallahassee, #2003-37 (May 2, 2003), available at http://www.occ.treas.gov/FTP/eas/ea2003-37.pdf.

[43] "OCC Closes Guaranty National Bank of Tallahassee and Appoints FDIC Receiver" (March 12, 2004) http://www.occ.treas.gov/scripts/newsrelease.aspx?Doc=GWZSYG2.xml.

> the fifty states—California, New York and Washington State—there are the equivalent of 56 full-time professionals reviewing and investigating consumer complaints. Moreover, this does not even include the numerous other attorneys and paralegals devoted to consumer protection investigation and enforcement in the offices of state attorneys general in just these three states.[44]

While a staff of 1,800 examiners cited by the OCC may sound impressive,[45] such personnel have duties other than policing the market for predatory loans. As stated by Joseph A. Smith, Jr., North Carolina's Commissioner of Banks, "[U]se of bank examinations as an enforcement tool with regard to mortgage lending would be limited in effect. A matter that is significant at the state or local level may—and probably will—be considered immaterial when viewed in the context of the total business of a large national bank or its subsidiary."[46] Current OCC staff are clearly inadequate to the task of reviewing the almost five million home loans—or 2,700 loans per examiner—reported under the Home Mortgage Disclosure Act to the OCC in 2002. According to its website, the OCC's Consumer Assistance Group alone received 78,000 phone calls last year.[47]

And what happened to those phone calls? The OCC opines in the Question and Answers accompanying its final rule that:

> The OCC's Customer Assistance Group…also plays an important role in helping to identify potential violations of consumer protection law and unfair or deceptive practices. CAG provides immediate assistance to consumers and also collates and disseminates complaint data that help direct OCC examination resources…

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[44] Letter from Helen P. Howell to John D. Hawke, Jr. (10/3/03).
[45] See "Notice of Proposed Rule Making Regarding 12 C.F.R. Parts 7 and 34 Bank Activities and Operations: Real Estate Lending Activities Questions and Answers" at 2 (July 31, 2003).
[46] North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. letter to Comptroller John D. Hawke, Jr. (October 2, 2003) (*available at* http://www.banking.state.nc.us/reports/Hawke.pdf).
[47] See Office of the Comptroller of the Currency, The OCC Customer Assistance Group, *available at* http://www.occ.treas.gov/customer1.htm.

The "immediate assistance" available to consumers is best described by OCC's own website for the CAG:

> It is best to resolve a complaint directly with your bank before involving an outside agency.
>
> When resolution seems impossible, you may file a formal complaint with the OCC.
>
> When we receive your call about a complaint, a customer assistance specialist will request certain information from you about your complaint. Should the specialist not be able to resolve your complaint immediately . . . [t]he specialist will assign you a case number and tell you exactly what they require you to provide, so that your case research can continue.
>
> Many complaints stem from factual or contract disputes between the bank and the customer. Only a court of law can resolve those disputes and award damages. If we find that your case involves such a dispute, we will suggest that you consult an attorney for assistance.[48]

Of course, this all assumes that a borrower even figures out that the Customer Assistance Group exists. How are borrowers supposed to know that the OCC is their only source of recourse if a national bank, or its operating subsidiary, has taken advantage of them? As far as we know, the OCC has never advertised the existence of its Customer Assistance Group to the general public, and we are not aware of any plans it has to do so. Forcing borrowers to rely solely on the OCC for recourse is like shutting all the hospitals but one in the middle of an epidemic, and then telling patients where the hospital is located only if they manage to show up at the front door. Since the birth of our country, borrowers have looked to State officials to help resolve their disputes. Now, they must look only to a federal office located somewhere in Texas.

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[48] *Available at* http://www.occ.treas.gov/customer.htm.

The OCC's enforcement resources are diluted further in light of the enormous reach of its preemption interpretation. Because preemption applies to operating subsidiaries, and potentially even joint ventures that are owned by national banks or their subsidiaries, we actually cannot quantify the number of institutions the OCC intends to monitor by itself. Given the ease of incorporating new subsidiaries and ample opportunities to "joint venture" with a multitude of other state-chartered lenders and brokers,[49] it is impossible to believe that the OCC alone can sufficiently address predatory lending on this scale.

III. The system proposed by the OCC in its final regulation – one that protects banks at the expense of borrowers – is contrary to Congressional intent.

When our Coalition worked together to craft the North Carolina law, we were mindful of the effects of existing preemption precedent, but we never imagined that the OCC would take the incredibly expansive approach it has chosen in its final rule. The OCC has no independent authority to preempt state laws. Rather, it must follow Congressional intent when carrying out its statutory responsibilities. In this matter, the OCC has ignored clear statements of Congressional intent. Moreover, the OCC's standard for preemption is a departure from generally accepted judicial standards.

In the Conference Report on the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, the Conferees identified two actions by the OCC that the Conferees thought were "inappropriately aggressive, resulting in preemption of State law

[49] Wells Fargo Home Mortgage, an operating subsidiary of Wells Fargo's National Bank, owns at least a 50-50.1% share in approximately 85 joint ventures. The joint ventures originate subprime mortgages and direct them through WFHM's subprime channel through contractual broker arrangements. *See* Wells Fargo

in situations where the federal interest did not warrant that result."[50] The Riegle-Neal Act also reinforced Congress' position on the preemption of state law in several specific areas, establishing that when a state statute is not expressly preempted by federal law and that statute does not discriminate against national banks, "[t]he laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State."[51] The Riegle-Neal Act further required the OCC to enforce state law in those areas, specifying that "[t]he provisions of any State [law pertaining to community reinvestment, consumer protection, fair lending, and establishment of intrastate branches] to which a national bank is subject . . . shall be enforced, with respect to such branch, by the Comptroller of the Currency."[52]

Finally, the Act established new procedures that the OCC must follow when it seeks to preempt state laws regarding community reinvestment, consumer protection, fair lending, and the establishment of intrastate branches. In this way, Congress acted to "ensure that an agency only makes a preemption determination when the legal basis is compelling and the Federal policy interest is clear."[53] Especially with regard to the state-licensed operating subsidiaries of national banks, the federal policy interest in preempting consumer protection laws is far from clear.

Letter to Shawn McNulty, Board of Governors of the Federal Reserve System, *Response to Request for Information* at 24-25 and Question 4 - Exhibit 1 (August 11, 2003)

[50] H.R Rep. No. 103-651, at H6638 (1994).

[51] 12 U.S.C. § 36(f)(1)(A) (indicating strong Congressional preference to preserve these types of state laws).

[52] 12 U.S.C. § 36(f)(1)(B).

[53] H.R. CONF. REP. 103-651 at 55 (on the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act).

Congress affirmed its position that states have a legitimate interest in protecting consumers' rights and a corresponding interest in the activities and operations of all banks doing business within their jurisdictions. The conference report states:

> 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 [this] balance of Federal and State law under the dual banking systems.[54]

In the Riegle-Neal Act, Congress was careful not to disrupt settled law on preemption: "[N]ational 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."[55] The OCC's proposed rules completely ignore Congress's finding that states have a strong legitimate interest in protecting consumers from being harmed by a bank's activities—regardless of the type of charter the bank holds.

In passing the Gramm-Leach-Bliley Act of 1999,[56] Congress expressly endorsed the Supreme Court's standard for preemption of laws affecting national banks: States may not act "to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[57] The Barnett analysis referenced in Gramm-Leach-Bliley asks whether compliance with both state and federal law is a "physical impossibility" or

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[54] H.R. Conf. Rep. No. 103-651 at 53 (on the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act).
[55] Id. at 53.
[56] 15 U.S.C. s. 6701(d)(2)(A).
[57] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1966).

whether compliance with a state law would "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[58] As the Barnett court emphasizes, the fundamental test governing whether a state statute regulating national banks is preempted by federal law is whether there is an "irreconcilable conflict" between the laws.[59] State anti-predatory lending laws do not make compliance with the National Bank Act or with other federal consumer protection laws physically impossible. They do not stand in irreconcilable conflict with bank powers. Rather, state anti-predatory lending laws attach additional protections to a small segment of subprime mortgage loans that tend to be abusive.[60]

The OCC has disregarded Congressional intent and invented its own standard for preemption: States may not "obstruct, impair, or condition, a national bank's ability to fully exercise its Federally authorized real estate lending powers." By lowering the threshold for preemption, the OCC has created a standard that allows it to preempt any law it doesn't like. The only state laws that the OCC does not purport to preempt are those that "only incidentally affect" a bank's activities. This approach is similar to statements made in the OCC's original proposal for the preemption rule that, generally, "the types of laws that are not preempted are *those that promote a national bank's ability to conduct business.*"[61] In other words-- if a state law is seen by the OCC as beneficial to national banks, it will not be preempted, whereas any laws that the OCC supposes not to benefit national banks will be preempted. This shift to preempt any law that, in the view

[58] Barnett, 517 U.S. at 31.
[59] *See* Barnett at 31.
[60] In particular, state anti-predatory lending laws target many of the same kinds of loans identified as problematic by the report of a joint U.S. Department of Housing and Urban Development-U.S. Department of the Treasury Task Force. *See* "Curbing Predatory Home Lending" at 21-22 (June 2000) (finding consistent evidence of loan flipping, excessive fees, fraud, and lending without regard to the borrower's ability to repay the loan).

of the OCC, fails to affirmatively aid national banks ignores a history of legal precedent and reduces the role of states to mere instrumentalities of the OCC.[62] This result was not intended by Congress (and is not pemitted under the Constitution).

Applying a true conflict analysis would make it clear that, at most, the National Bank Act only preempts a narrow range of state laws, where such provisions are directly in conflict with and significantly impair activities authorized by federal law. Therefore, state restrictions on predatory lending practices are consistent with, rather than irreconcilable with, the National Bank Act, and thus, are not broadly preempted under recognized standards of federal preemption. At most, such laws require that national banks do not engage in abusive lending – a set of practices Congress did not intend to empower national banks to engage in when it enacted or subsequently amended the National Bank Act.

Given that state anti-predatory lending laws do not reduce the ability of banks to make loans to low-wealth borrowers, and that the OCC believes that few national banks directly participate in predatory lending, preemption of state consumer protection laws in this vein seems unnecessarily aggressive and likely to hurt the very consumers who need protection the most.[63] The vast majority of national banks exercise the full extent of their authorized powers under the National Bank Act without running afoul of any state consumer protection laws. Given the vibrancy of national banks and the subprime

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[61] 68 Fed. Reg. at 46128. (emphasis added).
[62] This "instrumentalities" approach is most clearly evident in the rule's assertions that the National Bank Act be construed to preempt application of state laws to state-chartered corporations.
[63] The OCC has itself stated that "Based on the dearth of [evidence the national banks are engaged in predatory lending practices] – from third parties, [OCC] consumer complaint database, and [OCC] supervisory activities – [OCC has] no reason to believe that national banks are engaged in such practices to any discernable degree." 68 Fed. Reg. at 46125. *See also* "OCC Advisories to National Banks Regarding Predatory and Abusive Lending Practices and Notice of Request for Preemption Determination or Order;"

market, it is hard to see how state anti-predatory lending laws have frustrated or obstructed the purposes of the National Bank Act.[64]

In its explanation of its new and weaker standard, the OCC essentially ridicules those who pointed out (during the rulemaking process) its novel interpretation.[65] While it claims to be distilling Supreme Court constructions (and seems to claim that a federal agency is better equipped to do this than Congress or the judiciary), the OCC is actually ignoring the substance of the underlying decisions—which are impossible to reconcile with the OCC's view that <u>any</u> inconvenience to a bank in exercising even incidental powers is cause for preemption.[66]

Typically, courts defer to an agency's interpretation of the laws it is charged with implementing because of the agency's special expertise. The Supreme Court has not resolved whether deference to such judgments is appropriate, however, with regard to preemption.[67] Preemption is a determination that rests on legal analysis rather than technical competence or even policy studies. Moreover, the incentives for a federal agency to preempt state laws and thus enlarge its own power make deference to agency preemption decisions inappropriate.

OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 21, 2003 at 1.

[64] In fact, we believe these laws will facilitate a more transparent and competitive subprime market, which in all likelihood would benefit national banks.

[65] The OCC states, "The variation among formulations that carry different linguistic connotations does not produce different legal outcomes."

[66] In fact, although the OCC asserts that state predatory lending laws increase costs for banks, the OCC provides no evidence to support this claim. National banks already comply with a panoply of different state property tax rates, insurance regulations, and foreclosure procedures regardless of the OCC's rule. Thus, while the OCC argues that it must protect national banks from the administrative burdens presented by state anti-predatory lending laws, compliance with different state laws is a routine task.

[67] See, e.g., <u>Medtronic, Inc. v. Lohr</u>, 116 S.Ct. 2240, 2263 (1996) (O'Connor concurring in part, dissenting in part: "It is not certain that an agency regulation determining the pre-emptive effect of *any* federal statute

IV. The OCC's final regulation will make national banks a safe haven for predatory lending.

The OCC's efforts to make the national bank charter more attractive than other chartering options will have a pernicious effect on both borrowers and on national banks. We believe this rule will promote predatory lending by banks and their subsidiaries, not reduce it.

First, the OCC has not only obviated strong state law protections, but it has replaced them with vague and inadequate standards. The OCC relies on a prohibition of asset-based lending and a reference to the FTC Act's ban on unfair and deceptive practices. Rather than prevent practices by making clear to lenders what they may and may not do – as state anti-predatory lending laws have done -- the OCC is planning to rely on a post-hoc "we'll know it when we see it" approach to predatory lending. By putting forward such an inadequate proposal for protecting homeowners, the OCC has rendered hollow its pledge to halt unfair and deceptive acts by national banks.[68] Without clear standards, bank examiners are highly unlikely to determine that banking practices violate the FTC Act. In the absence of specific substantive standards, regulated institutions are unlikely to invest in the sorts of internal training and protocols that would steer employees away from abusive practices.

Second, the OCC ignores existing evidence of predatory lending within national banks and their affiliates and subsidiaries.[69] Despite some contradiction between this

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is entitled to deference, cf. *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 743-744, 116 S.Ct. 1730, 1734-1735, 135 L.Ed.2d 25 (1996).").

[68] See, e.g., OCC Advisory Letter 2002-3.

[69] See, e.g. comments by Comptroller Hawke stating that "while the OCC has *no reason to believe that any national bank is engaging in predatory lending*, the agency's guidance will help prevent problems from arising in the future by prescribing steps national banks should take to avoid abusive practices." OCC News Release 2003-8: OCC Issues Guidelines to National Banks to Guard Against Abusive Lending Practices (Feb. 21, 2003); "We have no evidence that national banks (or their subsidiaries) are engaged in such

claim and the assertion that OCC has led pioneering efforts to shut down predatory lending, this claim is belied by allegations brought by consumer advocates and researchers regarding national banks, such as Wells Fargo. National advocates believe that Wells Fargo has engaged in numerous abusive lending practices, both through its affiliated subprime entity as well as directly through its operating subsidiary, Wells Fargo Home Mortgage. Allegations include charges that Wells Fargo charged subprime borrowers substantial amounts in prepayment penalties, dramatically under-reported subprime lending activities under HMDA, and used spurious open-end loans to evade consumer protection laws.[70] Wells Fargo has also been the subject of several additional complaints and lawsuits regarding the abusive use of live check solicitations by its subprime affiliate, racial steering, and lending discrimination.[71] Despite specific requests to the OCC to hold hearings on these issues, the OCC – the primary regulator for Wells Fargo– has determined that hearings are not necessary and has failed to provide a substantive response to comments.

practices to any discernible degree." Statement Of Comptroller Of The Currency John D. Hawke, Jr. Regarding The Issuance Of Regulations Concerning Preemption And Visitorial Powers (Jan. 7, 2004); "There is scant evidence that regulated banks are engaged in abusive or predatory practices," OCC, News Release 2004-3: OCC Issues Final Rules on National Bank Preemption and Visitorial Powers; Includes Strong Standard to Keep Predatory Lending out of National Banks (Jan. 7, 2004). By issuing guidelines to help national banks guard against a range of predatory lending practices, the OCC has acknowledged that national banks are not immune from a whole range of abuses. However, the guidelines are not in any way binding. OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 21, 2003; OCC Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 21, 2003.

[70] See, e.g., ACORN, "Stop the Stage Coach," available at www.acorn.org/acorn10/predatory lending/plreports/stopthestagecoach.pdf. See Letter to Federal Reserve Bank of San Francisco from CRL (July 25, 2003) (*available at* http://www.responsiblelending.org/fed_state_update/fed_law.cfm); Letter from CRL to John D. Hawke (August 26, 2003); Letter from CRL to Federal Reserve Bank of San Francisco (September 29, 2003).

[71] See Christian Berthelsen, "State sues Wells Fargo; Bank accused of overcharging," San Francisco Chronicle at B1 (January 11, 2003); E. Scott Reckard, "State Sues to Void 'Instant Loans' by Wells Fargo Unit," Los Angeles Times (January 10, 2003); California Department of Corporations, Press Release, "Department of Corporations Files $38 Million Suit Against Wells Fargo Financial" (January 10, 2003).

As explained by North Carolina's Commissioner of Banks, the OCC's proposed rule would "create opportunities for regulatory arbitrage."[72] The OCC's proposed rule encourages banks to seek out the federal charter. It also encourages national banks to change their subprime lending affiliates into operating subsidiaries, increasing the OCC's responsibility for policing the subprime market and decreasing the states' ability to regulate subprime lenders.

Encouraging banks to evade state law by converting to national charters would undermine longstanding federal policy that supports the dual banking system. Congress has always worked to ensure that both components of the dual banking system remain strong. The potential impact of the OCC's proposed rulemaking on the dual banking system has not even been studied. In North Carolina, we have the strongest national banks and the strongest state-chartered banks in the country. We would hate to see competition among these banking entities undermined by the OCC's creation of a safe haven for abusive practices.

The OCC's rush to judgment on state predatory lending laws plants the seeds for long-term trouble in the national banking system. Abusive practices may well be profitable in the short term, but are ticking time bombs[73] waiting to explode the safety and soundness of national banks in the years ahead. The OCC has not only done a tremendous disservice to hundreds of thousands of homeowners, but has also sown the seeds for future stress on the banking system.

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[72] Letter from Smith to Hawke (10/2/03).

[73] The OCC's closure last month of Guaranty National Bank after long-running concerns about its predatory lending practices is a small reminder of the danger to taxpayers of unchecked predatory lending. *See also*, E. Scott Reckard, "Pritzkers in Record Thrift Settlement Banking: The family and its partner agree to pay FDIC $460 million for losses at Superior," L.A. Times at C-1 (Dec. 11, 2001) (discussing the collapse of Superior Bank after "losing millions of dollars on high-risk loans").

Congress has traditionally applied its own consumer protection laws to all financial institutions, maintaining a level playing field for state and federal institutions. In addition to the National Bank Act and the Riegle-Neal Act, other federal laws such as the Home Ownership and Equity Protection Act (HOEPA)[74] and the Real Estate Settlement Procedures Act (RESPA)[75] all anticipate the application of state law to national banks' real estate finance activities. In fact, HOEPA and RESPA have allowed states to enact comparable or stronger state legislation while avoiding preemption under the federal statutes.[76] Additionally, the Fair Housing Act,[77] the Equal Credit Opportunity Act,[78] and the Federal Trade Commission Act,[79] all regulate the real estate finance market without broadly preempting comparable state regulations. We would encourage Congress to confirm that it intends the same principle to apply here—federal law should be a floor, not a ceiling, and federal regulators should be required to support state efforts to protect their consumers from predatory lending abuses.

<u>Conclusion</u>

Unfortunately, the practical effect of the OCC's new rules as a whole will be to increase predatory lending, not reduce it. The few bad apples among national banks will be able to ignore state consumer protection laws with impunity, and borrowers will have no effective remedy when they face losing their homes to foreclosure. Further, the new rule will have the effect of encouraging lenders to shelter questionable practices under a national bank charter. Even worse, the OCC's expansive interpretation of the standard

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[74] Pub. L. No. 108-68, 108 Stat. 2190 (1994).
[75] 12 U.S.C.A. § 2601 et. seq. (as amended).
[76] *See* 15 U.S.C. § 1610(b), 12 U.S.C. § 2616.
[77] 42 U.S.C.A. § 3601 et. seq. (as amended).
[78] 15 U.S.C.A. § 1691 et. seq. (as amended).

for federal preemption dramatically alters the current partnership between the federal government and the states in promoting a dual-banking system and in protecting the nation's consumers. Rather than help to support the fight against predatory lending, the OCC has used strong rhetoric, biased research, and contorted legal analysis to undermine effective state efforts to combat predatory lending without cutting off access to credit.

We respectfully ask that Congress act to overturn the OCC's rules preempting state consumer protections, and encourage the OCC to partner with the states in establishing meaningful consumer protections against predatory lending where federal standards serve as a floor, and not a ceiling, for homeowner protections.

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[79] 15 U.S.C.A. § 41 et. seq. (as amended).

Testimony of

Joe Belew

President, Consumer Bankers Association

on

OCC Final Rules on National Bank Preemption and Visitorial Powers

before the

Senate Banking, Housing and Urban Affairs Committee

of the

United States of America

On

April 7, 2004

Mr. Chairman and members of the Committee, my name is Joe Belew. I am President of the Consumer Bankers Association, which represents banks nationwide. CBA's members include most of the nation's largest bank holding companies as well as regional and supe: community banks that collectively hold two-thirds of the industry's total assets. The vast majority of our members are national banks.

In my role as President of the Association, I interact daily with the heads of the retail banking operations—the men and women who are responsible for many of the lending and deposit taking activities that are subject to the OCC's actions. I am very pleased to have the opportunity to share with you CBA's views on this subject—a subject that is very important to our member institutions. For the record, I am also attaching CBA's comment letter to the OCC in response to the preemption proposal that resulted in the regulation that is the subject of this hearing.

We strongly support the OCC's regulations that define the applicability of state laws to the activity of national banks and their operating subsidiaries. Increasingly, in recent years, national banks have been facing the intrusion of state and local statutes and regulations on their federally created powers. The courts and the OCC have uniformly and consistently resolved each such instance when contested by reaffirming the supremacy of the national bank powers and the Constitutionally based preemptive effect of the National Bank Act. But there has remained a need for greater uniformity and predictability for national banks operating in multiple jurisdictions nationwide, and these regulations will provide that helpful guidance.

The final preemption rule, which the OCC issued only after it published a Notice of Proposed Rulemaking and reviewed approximately 2,600 public comments, clarifies the extent to which national banks are subject to state laws. The rule identifies the types of state laws that are preempted by the National Bank Act and, importantly, also identifies the types of state laws that are <u>not</u> preempted. Reflecting the history of judicial rulings, the types of laws that are preempted include those laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses. These are types of laws that create impediments to the ability of national banks to exercise powers that are granted under federal law. For the record, they are very similar to the types of laws preempted for federally chartered thrifts and credit unions by the regulations of the Office of Thrift Supervision and National Credit Union Administration. The OTS and NCUA rules have been in place for many years and have provided federal thrifts and credit unions with a set of predictable, uniform laws of operation.

The OCC regulation is clear that there are many types of state laws that are <u>not</u> preempted by the National Bank Act. These are laws that do not regulate the manner or content of the business of banking authorized for national banks, but rather establish what the OCC calls the "legal infrastructure" of that business. These generally include laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes and torts. The agency has also made it clear that the National Bank Act does not preempt any other law that only incidentally affects national banks' lending, deposit-taking, or other operations.

We believe it is important to recognize that the OCC is not breaking new ground by issuing this rule. The regulation is based on Supreme Court precedent dating back to 1869—135 years—consistently holding that national banks were designed to operate under uniform, federal standards of banking operations nationwide. By codifying over a century of court decisions and OCC interpretations, the agency is clarifying the law and responding to numerous questions about the extent to which various types of state laws apply to national banks and their operating subsidiaries. By a separate rulemaking, the OCC is also clarifying its exclusive visitorial authority over national banks and their operating subsidiaries. These two rules will give national banks the uniform and predictable standards that permit them to serve their customers in diverse markets nationwide.

These rules pose no threat to the dual banking system. States can and do adopt different rules for the institutions they regulate and supervise. On the other hand, many states, including Georgia—which was the subject of the OCC's recent preemption determination—have "parity" or "wild card" laws that give state chartered institutions the same coverage as national banks and federally chartered thrifts. Therefore, as the Comptroller has pointed out, it is up to the states to determine whether they believe a separate state code is appropriate or to employ the same rules as national banks or federal thrifts for state-chartered institutions.

Because so much attention has been directed at the important area of predatory lending and the recent enactment of state laws to address the problem, a charge has inevitably been leveled at the OCC that its actions will leave consumers vulnerable, by sweeping away these state protections and leaving nothing in their place. On the contrary, the OCC is second to none in its regulation and enforcement of consumer protection laws. National banks are subject to the whole array of federal consumer protection laws, from the Truth in Lending Act and the protections accorded by the Home Ownership and Equity Protection Act to the anti-discrimination provisions of the Equal Credit Opportunity Act and the Fair Housing Act. In addition, the OCC has tough guidelines in place that are unique to national banks, spelling out in detail what rules the banks and their operating subsidiaries must follow in order to ensure that all national bank lending, deposit taking, and other activity remain above reproach. We have attached a list of the many consumer protection standards to which national banks must stringently adhere.

As part of the preemption regulation, the agency has also added two additional provisions applicable to national banks, designed to provide an additional layer of protection for consumers. One provision provides that a national bank may not make consumer loans based predominantly on the foreclosure or liquidation value of the borrower's collateral. This places a total ban on any lending by a national bank that does not take into consideration the borrower's ability to repay, a ban on loans made with the expectation of profiting from foreclosure. The second provision added to the new rules states that a violation of section 5 of the FTC Act, which protects consumers against unfair or deceptive acts or practices, is a violation of the National Bank Act. This ensures that the OCC can employ its enforcement authority against banks that engage in any unfair or deceptive practices as defined by that act, and maintain its vigilant oversight to prevent predatory lending practices of any kind.

Indeed, it is predatory lending that has been the focus of much of the debate surrounding the OCC's recent actions. Yet the overwhelming evidence suggests that national banks and their subsidiaries are not a principal source of concern when it comes to any abusive or predatory practices. For example, an *amicus* brief filed last year by 22 state Attorneys General in the U.S. District Court for the District of Columbia stated, "Based on consumer complaints received, as well as investigations and enforcement actions undertaken by the Attorneys General, predatory lending abuses are largely confined to the subprime mortgage lending market and to non-depository institutions. Almost all the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries."[1] The object of the OCC's comprehensive rules and guidelines—along with the additional standards being adopted as part of this regulation--is to ensure that national banks remain the gold standard of responsible lending.

Our experience at CBA supports the assertion that national banks also take proactive steps to protect consumers from abusive practices of others. One universally recognized

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[1] National Home Equity Mortgage Association v. Office of Thrift Supervision, Brief of Amicus Curiae State Attorneys General in Opposition to Plaintiff's Motion to Summary Judgment and in Support of Defendant's Motion for Summary Judgment, Civ. Act. No. 1:02CV02506 (GK), US Dist. Ct, D.C., March 21, 2003 (Emphasis added)

way to shield consumers is to give them the education in financial services that permits them to recognize and avoid bad practices. As Federal Reserve Board Chairman Alan Greenspan said before this Committee, "In the quest to stem the occurrence of abusive, and at times illegal, lending practices, regulators, consumer advocates, and policymakers all agree that consumer education is essential to combating predatory lending. An informed borrower is simply less vulnerable to fraud and abuse."[2] National banks have demonstrated an ongoing commitment to educating customers as a means of protecting them from predatory practices.

For three years, we have surveyed our member banks to determine how involved they are in financial literacy efforts, as a measure of their sense of responsibility to the communities they serve. The most recent published survey showed that 98% of the respondents--with the majority being national banks--sponsor financial literacy programs or partner on financial education initiatives.

CBA's 2003 *Survey of Bank-Sponsored Financial Literacy Programs* shows a significant increase from the previous year, from 60% to 72%, in bank programs aimed at helping consumers avoid abusive or predatory lending practices. Over 70% of the respondents stated that their banks offered programs targeting issues such as flipping, avoiding unscrupulous lenders, excessive interest rates or payday loans.

[2] Testimony of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, February 5, 2002.

Additionally, 96% of these banks offer mortgage and home ownership counseling, typically in connection with an affordable mortgage program, which in turn is offered by 93% of responding banks. With 73%, credit counseling is mandatory to qualify for such programs. In addition, 37% of the 2003 respondents indicated that the institution had a foreclosure prevention program in place. The 2004 survey is not yet final, but the preliminary findings suggest that banks may be significantly increasing their involvement in programs that educate school children, both K-12 and college. This may reflect a growing awareness that the complexity of the financial products like mortgages call for a broad based understanding of finance that needs to be learned as part of the educational system.

This commitment to financial literacy is actively encouraged by the OCC as a means of combating predatory practices. Comptroller of the Currency John D. Hawke, Jr., in a speech to CBA members in which he advocated bank involvement in financial education efforts, put it this way: "Studies ... tell us that financial education is an indispensable element of any strategy to combat the rise of predatory lending. Although those who engage in predatory practices are relatively few in number -- and only rarely include regulated depository institutions -- they've done real harm to the reputation of all financial institutions. It's therefore very much in the industry's interests to assist in efforts to oust the bad actors."[3] Obviously, educating consumers is not the *only* solution to the problem of predatory lending practices, but national banks have found that they can use their resources and expertise, often in partnerships with communities and governments, to

[3] Remarks by John D. Hawke, Jr. Comptroller of the Currency, before the Consumer Bankers Association, Arlington, Virginia, April 8, 2002.

make a more financially educated population, who will be less vulnerable to abusive sales practices.

Although, as I have noted, national banks are not known to be involved in abusive lending practices, the OCC has the means to ensure that they remain above reproach. Because of the comprehensive examination oversight to which national banks are subject, the OCC can find and stop problems before they occur. If anything slips through the net, the agency can and will take enforcement action—everything from cease and desist orders to restitution—and it has a strong track record of taking action on the rare occasion it discovers national banks which may be engaged in abusive practices. In several recent cases, for example, the agency has imposed substantial monetary penalties on institutions. But the OCC's scrutiny in this area goes back for a number of years. At a CBA conference four years ago, for instance, OCC Senior Deputy Comptroller and Chief Counsel Julie Williams warned national banks: "We plan to use our supervisory powers -- through our safety and soundness, fair lending, and consumer compliance examinations; our licensing and chartering process; and individual enforcement actions -- to address any potential predatory lending concerns that might arise in national banks and their subsidiaries." [4] Thus, national banks have long been on notice that the OCC's examination and enforcement in this area is rigorous.

The agency employs nearly 1,700 examiners in its 48 field offices and 23 satellite offices, with over 100 working exclusively on compliance supervision. Over 300 examiners are

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[4] Remarks by Julie Williams, OCC Senior Deputy Comptroller and Chief Counsel, before the Consumer Bankers Association, Arlington, Virginia, June 5, 2000.

in the 24 largest national banking companies (many of whom are CBA members) as on-site examiners, engaged in the continuous supervision of those institutions. The OCC also maintains a Customer Assistance Group (CAG), which handles consumer complaints. The CAG, an efficient system the agency employs to address and resolve consumer complaints, is a supplement to the examination function, which efficiently and directly monitors the banks for compliance and safety and soundness matters. The level of oversight and staffing at the OCC is flexible enough to deal with increased compliance and enforcement needs. Since the OCC is funded directly from assessments and fees, it can adjust its overall budget annually to accommodate any increased needs that may follow from changes in the scope of its oversight. By contrast, state attorneys general are often operating under budget constraints, and must enforce a vast array of state laws against many different persons and businesses. Thus, the OCC's oversight of national banks and operating subsidiaries is not only a better means of enforcing compliance, but it frees up the resources of the states to tackle the other many issues they must face.

The OCC has also sought cooperation from the states where there may be allegations of wrongdoing by national banks or their operating subsidiaries. It has established special procedures for expedited referrals of consumer complaints from State Attorneys General and banking departments. In this way, the state law enforcement officers can pass on complaints to the OCC for follow up, and preserve their resources to enforce the state laws against predatory lenders and other bad actors. The agency recently issued a further clarification of the appropriate response by national banks to consumer complaints—regardless of their source. In a recent advisory letter, the OCC has told its banks that ordinarily they should deal directly with states that have referred consumer complaints and resolve the problems promptly, rather than referring the states or the complainant to the OCC.[5]

National banks benefit from being subject to a uniform set of rules that do not vary from state to state. Banks today operate across many state lines, permitting them to serve the needs of an increasingly mobile society. Some of our members operate in over half the states. A single set of rules permits them to provide economies of scale and streamlined services in a cost-effective way. Subject to comprehensive oversight, they are able to provide the quality products and services that can, through competition in the marketplace, help to drive out the bad actors that we all are trying to eliminate. But their ability to do so is severely hampered by the laws, regulations, and ordinances adopted in each jurisdiction. Since states do not have the kind of on-going scrutiny of unsupervised lenders and brokers that the OCC has over national banks, the laws are often overbroad—driving out the good with the bad. Forcing national banks to comply with all these myriad, often conflicting, state laws, would make it difficult if not impossible for national banks to operate in the uniform and efficient manner envisioned in the National Bank Act.

In conclusion, we strongly support the OCC's regulations clarifying the applicability of state laws to the activity of national banks and their operating subsidiaries. Its actions are in accord with the letter and spirit of the National Bank Act, as it has been consistently interpreted by over a century of court opinions; permitting national banks and their

[5] AL 2004-2 (Feb. 26, 2004).

operating subsidiaries efficiently to serve the needs of their customers nationwide without being hobbled by a hodge-podge of well-intentioned but disruptive laws in every locality. The extensive consumer protection laws to which national banks and their operating subsidiaries are subject, together with strong leadership and rigorous oversight by the OCC and its examination force, will ensure that national banks continue to serve consumers well in the future.

Once again, thank you for this opportunity to share our views.

CBA | CONSUMER BANKERS ASSOCIATION

Attachment A

October 3, 2003

John D. Hawke, Jr.
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E St., S.W.
Public Information Room, Mailstop 1-5
Washington, D.C. 20219

Re: Docket No. 03-16: Notice of Proposed Rulemaking on preemption of state laws.

Dear Mr. Hawke:

The Consumer Bankers Association[1] (CBA) is pleased to have the opportunity to submit these comments in connection with the proposed rulemaking concerning preemption of state laws, involving amendments to Parts 7 and 34 of the OCC Regulations.

CBA supports wholeheartedly the thrust and direction of the proposal. Over more than a century, and especially in recent decades, it has become abundantly clear that the constitutionally preemptive effect of the National Bank Act and other federal laws relating to the powers of national banks cannot be undercut by state law that interferes with the exercise of those powers. A virtually unbroken line of judicial decisions and OCC interpretations has solidified the notion that national banks must be able to exercise the full range of federally established banking functions, without interference or burden from state regulatory and visitorial regimes.

With legislative and regulatory activity in the states increasing in recent years, it has been necessary for the courts and the OCC to address a series of instances in which state law arguably crosses the federalism line and intrudes on the protected powers of national banks. The proliferation of these challenges, arising not only from regulatory activity in fifty states, but from countless municipal and other local government activities as well, underscores the need for uniform ground rules and oversight for national banks. While the courts and the OCC have regularly reaffirmed the supremacy and independence of national bank powers, the pattern has been one of *ad hoc* determinations, with uncertainty on all sides until the particular state-federal friction has been resolved. And since the preemptive effect of federal law is constitutionally

[1] The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

based, in a sense none of these determinations makes new law, but rather each is simply declaratory of the supremacy clause mandate.

Against this background, we understand that the OCC's intent in the proposed rulemaking is to provide clearer and more comprehensive guidance as to the range and scope of federal preemption regarding national bank powers. CBA strongly supports that objective. OCC guidance in this respect will provide helpful reassurance, uniformity, and predictability to bankers, regulators, and the public at large, on the impact of national bank powers and the boundaries for state-law applicability to those banks. In the process, this rulemaking would help equalize and balance the positions of federal thrift institutions under OTS and NCUA oversight, and national banks under OCC supervision.

The underlying issue is not whether state regulation is better or stronger than federal, or vice versa. It is, rather, whether national banks are able to operate and compete in national markets in accordance with federal law and federal supervision, without also being subjected to a flood of differing state and local laws and regulations that create redundancies, inefficiencies, compliance costs, and competitive disadvantages for those national banks. State chartered financial institutions must of course comply with state law, but those state institutions are not subject to the overlay of federal law and supervision that applies specifically to national banks. National banks, in turn, cannot effectively implement their federal charter powers under a blanket of additional, duplicative – and stifling – state and local regulation. In fact, for national banks conducting business across state lines, it is not a single blanket of state law, but potentially fifty – and many more when local jurisdictions are considered.

This is hardly to say that national banks are, or are asking to be, unregulated or free to engage in unscrupulous practices. The body of federal law that empowers national banks also orders and restrains bank operations for the protection of bank customers, investors, and the public at large. All of the federal consumer financial services laws, such as TILA, ECOA, and TISA, apply fully to national banks, as does the general proscription on unfair or deceptive practices under the FTC Act. The OCC has articulated substantial regulatory guidance on permissible and proscribed practices for national banks in all areas of their operations. No example is more current than the OCC guidelines relating to predatory lending, and incorporated in this rulemaking.

Most importantly, every national bank (and its subsidiaries) is subject to close scrutiny of its activities through the bank examination process, and the OCC has clearly indicated its ability and willingness to act against banks that exceed the bounds of appropriate conduct. There is no vacuum of federal law or oversight relating to the protection of national bank customers that needs state law to fill it.

We do not understand the current proposal to be an effort by the OCC to raise the bar of federal preemption, or to displace state law more broadly than precedents and tradition dictate. Rather it provides more bright-line guidance, in advance, as to the scope of the federal preemption. The result will be more certainty and consistency in the application of preemption principles, and less need for ad hoc challenges that are wasteful, time consuming, and inefficient.

"Field" vs. "conflict" preemption.

CBA concurs with the OCC suggestion that mortgage lending powers under Part 34 of the regulations should be treated as a matter of "field" preemption. The real estate lending authority for national banks and their subsidiaries derives from a separate and discrete statutory source (NBA § 371), and the legal framework for such lending has been extensively developed through federal statutes and agency regulations, including extensive guidance from the Federal Reserve Board, HUD, and the OCC itself. There is no need or justification to retain any significant state regulatory or visitorial role with respect to that aspect of national bank operations.[2]

For the proposed revisions in Part 7, which cover a wide waterfront of national bank operations from credit cards to deposit accounts to investment services, it is extremely helpful that the proposal lists the types of state laws that would be subject to preemption in each of the categories addressed (deposit taking, lending, other activities). It is justifiable, we believe, to state the preemptive effect of federal law in terms of general categories of state law, without the need to examine the details of each state initiative and to assess the degree-of-conflict it presents. The real conflict, obstruction or burden of state law arises not so much from the impact of any single state law, but rather from the possibility – indeed the likelihood – that an endless variety of different and irreconcilable homegrown regulations would emerge in the states, confronting national banks with an impenetrable morass of idiosyncratic state laws. For national banks operating countrywide or regionally, the burden of complying with that aggregate of differing state laws is the real "conflict" and the real justification for preemption.

We suggest several adjustments to the lists of state laws preempted in connection with lending transactions [§ 7.4008(c)(2)]. The list might explicitly include state laws dealing with **non-interest fees and charges**, since these are inextricably related to the bank's pricing of its credit products.[3] The lists ought also to include the **collection of debts in default**; there is no reason to preserve for national banks the powers to market, price, book, and service loans, without also protecting their ability to follow the collection trail to its conclusion after default.

The preemption boundaries for preempted and retained ("incidental") state laws

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[2] We understand that, under the proposal, even when field preemption applies, there is a residuum of state law that will continue to apply to national bank operations as part of the "infrastructure" of state law applicable generally to business activity in the state. Proposed § 34.4(b).

[3] We appreciate that OCC may understand that non-interest fees are dealt with in 7.4002, and therefore do not need a separate preemption statement.

We recognize that a stream of *ad hoc* judicial or administrative determinations about preemption, arising out of concrete examples of conflict between federal and state law, can be a frustrating and time-consuming process, as each challenge is resolved on its specific circumstances. But at least there is, usually, a definitive answer to that particular preemption issue. A comprehensive, across the board, regulatory statement on preemption of state law is inherently attractive, and CBA supports the proposed rulemaking for exactly this reason. But there is a degree of risk in shifting to a broader, more generic regulatory approach – as the pending rulemaking does. Each section of the proposed regulatory amendments lists, by "type," the kinds of state laws that are preempted, and others that are generally not preempted. Each of these lists is stated as a set of very broad categories. There is the potential that these two lists will be read in parallel, and as mutually exclusive, where we do not believe this is the OCC's intent; state law that provides "infrastructure"and "merely incidental" regulation of business activity will still need to be evaluated against the traditional preemption criteria. We therefore suggest it may be preferable to delete the broad categorical lists of state laws that are not preempted, lest the lists themselves, and the relationships between them, become the focus of preemption challenges. Alternatively, to provide greater certainty and predictability, the OCC might consider elaborating on the scope of these categories, either in the regulation proper or in authoritative interpretational material related to it.

Predatory lending policy

CBA strongly supports the proposed statements concerning asset-based lending in sections 7.4008(b) and 34.3(b). We urge the OCC, when interpreting this language, to keep in mind that there are sophisticated and streamlined credit products in the market, such as "low-doc" and "no-doc" loans, where income may not be considered directly, in order to serve the convenience and needs of applicants with good credit. These products are not likely to raise the predatory lending concerns that are addressed in the proposal.

We would be pleased to discuss any of these matters further with you or the OCC staff, and we thank you for considering our views.

Sincerely

Steven I. Zeisel
Senior Counsel

Ralph J. Rohner
Special Counsel

Attachment B

Federal Consumer Protection Standards that Apply to
National Banks and National Bank Operating Subsidiaries

- Federal Trade Commission Act
- Truth in Lending Act
- Home Ownership and Equity Protection Act
- Fair Housing Act
- Equal Credit Opportunity Act
- Real Estate Settlement Procedures Act
- Community Reinvestment Act
- Truth in Savings Act
- Electronic Fund Transfer Act
- Expedited Funds Availability Act
- Flood Disaster Protection Act
- Fair Housing Home Loan Data System
- Credit Practices Rule
- Fair Credit Reporting Act
- Federal Privacy Laws
- Fair Debt Collection Practices Act
- Consumer Leasing Act
- Fair Credit Billing Act
- CCPA Garnishment Restrictions
- Check Clearing for the 21st Century Act
- OCC anti-predatory lending rules in Parts 7 and 34
- OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements
- OCC standards on unfair and deceptive practices
- OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions

STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE
THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

SUBMITTED BY
WALTER T. MCDONALD
PRESIDENT

April 7, 2004

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

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

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

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

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

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

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

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

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

The Federal Register preamble further provides:

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

Id.

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

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

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

69 Fed. Reg. at 1912.

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

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

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

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

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

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

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

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

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

Many REALTORS® who operate mortgage, title, appraisal and other businesses are unfairly impacted by this unbridled grant of preemption for national banks and their operating subsidiaries. The OCC stated in its rule release that requiring state licenses could "create higher costs and operational burdens that banks either must shoulder, or pass onto consumers, or that may have the practical effect of driving them out of certain businesses." While it may require higher costs, those costs are shared by <u>all businesses</u> that operate within that state. Is it fair for national banks to be exempt? National banks and their subsidiaries have recently enjoyed their most profitable years in history. We don't think these profits suffered from compliance with state laws. The OCC seems to have ignored the old saying that "if it ain't broke, don't fix it."

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

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

The OCC has consistently relied on the broadest misinterpretation of the law to determine that national banks may avoid state consumer protection, insurance and lending laws due to their federal charter. Congressional intent is unclear, and the OCC currently is taking advantage of this lack of clarity. Nevertheless, Congress has repeatedly upheld the dual banking system and limited the authority of the OCC to preempt state laws.

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

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

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

> "forbid, or (to) impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers."

The Court continued by citing three supporting cases where the Court held certain state laws did not "unlawfully encroach,"[1] would not "destro[y] or hampe[r]"[2] and do not "interfere with, or impair"[3] national banks' functions, rights or privileges.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Testimony of William M. Isaac
Chairman, The Secura Group
Before the Committee on Banking, Housing and Urban Affairs
The United States Senate
April 7, 2004

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

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

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

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

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

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

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

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

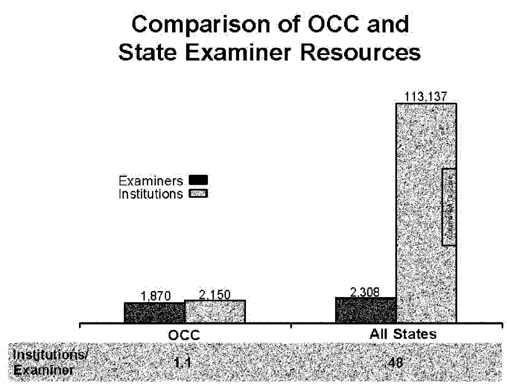
It serves neither banks nor customers of banks to make it incredibly inefficient and expensive for banks to operate across jurisdictional lines. It would be a nightmare if national banks were required to comply with scores, if not hundreds, of state and local regulations on their products, services and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

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

The contention by various state attorneys general that they are more effective on behalf of consumers than the Comptroller of the Currency strains credulity. The Comptroller has nearly two thousand supervisory personnel dealing with national banks each day. Those personnel have enormous legal authority and even greater moral suasion with respect to national banks. While an attorney general is huffing and puffing and threatening to go to court against a bank, without much effect, all it takes is a frown from the Comptroller to bring a national bank into line. This is particularly true of the larger banks, which simply have no choice but to maintain the very best of relations with their regulators if they wish to grow and prosper.

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

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



Source: Conference of State Bank Supervisors, OCC Annual Report

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

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

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

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

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

If Congress were to repeal the Comptroller's historical power to preempt state laws that interfere with the authority and activities of national banks, there is a very good chance that the national banking system will be brought to the brink – possibly bringing an ironic end to our dual banking system and higher prices to the very consumers we claim we want to protect. Adding irony on top of irony, the states would gain little authority, as most of the larger banking companies would switch their national bank charters not to state charters but to federal thrift charters, which offer even clearer federal preemption and the ability to offer an even broader range of retail financial services.

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

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

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

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

TESTIMONY OF

ARTHUR E. WILMARTH, JR.

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

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[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

[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

[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

[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

[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

[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

[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. . . .
>
> 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.
>
> 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

[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

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[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, becaus 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:
>
> > "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)

Testimony of James D. McLaughlin
On Behalf of the American Bankers Association
Before the
Committee on Banking, Housing, and Urban Affairs
United States Senate
April 7, 2004

Mr. Chairman, I am James D. McLaughlin, Director Regulatory and Trust Affairs of the American Bankers Association (ABA). ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings institutions, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

The ABA is pleased to testify on the final rule recently issued by the Comptroller of the Currency ("OCC") clarifying the types of state laws that apply to national banks' lending and deposit-taking activities and the role of state regulators in enforcing state laws against national banks.[1] Congressional oversight in this area is certainly appropriate. ABA strongly supports the OCC's rule because it provides greater certainty to national banks (particularly those that conduct business in more than one state), thus enabling greater efficiency, lower regulatory and legal costs, and enhanced delivery of financial services for bank customers. At the same time, we support the new standard designed to prevent possible predatory lending practices.

National banks operate in national credit markets, typically with a physical presence in many states. They are already subject to a comprehensive set of federal laws, including consumer protection laws. An expanding universe of differing state laws would impose substantial burdens on the conduct of their federally authorized activities. Absent preemption, the proliferation of state and local laws that would apply to those activities would inevitably lead at best to higher operating costs, and higher prices for financial services; at worst, it would lead to a reduction in available credit and fewer product options. ***More fundamentally, if state and local authorities are permitted to regulate the lending and deposit-taking activities of national banks, it is hard to see how we***

[1] The rule amends the OCC's rules at Part 34 (real estate lending authority) and Part 7 (deposit-taking and non-real estate lending powers). Although substantively similar, the rule amends two separate provisions of the OCC's regulations because there is separate statutory authority for real estate lending. In addition, the rule imposes a new standard on all consumer lending that is intended to prevent predatory lending practices. 69 *Federal Register* 1904, (January 13, 2004).

would continue to have a dual banking system. After all, what is more fundamental to banking than lending and taking deposits?

To a very large degree, the OCC rule does not break new ground. The areas covered in the rule have in many cases already been subject to preemption by the OCC in its rules and determinations or by the courts. In the past, these preemptive rulings by the OCC went forward generally on a case-by-case basis. That approach worked when the state and local actions that were preempted occurred infrequently. Recently, however, we have seen a proliferation of such state and local actions. Several of these ended up in the courts where preemption under the National Bank Act was upheld. We believe, therefore, that it was very important and correct of the OCC to issue this rule in order to make it clear to all parties where the line in preemption is. While most legal experts in this arena know that state and local laws that impinge on the fundamental activities of national banks violate the National Bank Act, apparently state and local officials have often proceeded despite the virtual certainty that their law or regulatory effort will be struck down by the courts as it pertains to national banks. In the meantime, national banks face the costly uncertainty as to how to proceed with the affected business. Banks (and their trade associations), the OCC, and the taxpayers of those state and local governments end up wasting considerable resources in litigation. This OCC rule will help avoid that uncertainty and litigation cost by bringing together in one place what was, in fact, occurring on a case-by-case basis in any event.

In my statement today, I would like to make four points regarding the OCC's preemption regulation:

- First, it is based on a long history of constitutional and legislative intent, affirmed by the courts, and it is consistent with actions of other regulators of federally chartered depository institutions.
- Second, preemption is necessary to preserve the dual banking system.
- Third, preemption of state laws will not diminish the protection of consumers.
- Fourth, options exist to address specific issues—such as predatory lending practices—without undermining the dual banking system.

These four points are explained in detail in the remainder of this statement.

I. The OCC's Rule is Based on a Long History of Constitutional and Legislative Intent

The OCC's preemption regulation is firmly based on laws enacted one hundred and forty years ago, during the administration of Abraham Lincoln. The Congress created the national banking system and clearly delegated to the Comptroller of the Currency the powers to regulate that system – including the power that is the basis of the new rule. The rule is firmly supported by longstanding U.S. Supreme Court analyses of conflicts between federal and state law. Over the last 140 years, the Supreme Court has consistently recognized that state laws are preempted where they:

(1) Impair the efficiency of national banks to exercise federally authorized powers;
(2) Conflict with federal law;
(3) Frustrate the purpose of the National Bank Act; or
(4) Obstruct the scope and effective exercise of unconditional national bank powers.[2]

ABA believes that there can be no doubt that the OCC's rule has correctly incorporated the Supreme Court's preemption doctrine. A listing of some of the court cases on which the OCC's rule is based is attached to this statement.

The OCC's rule clarifies that state laws that affect the way national banks conduct activities authorized under the National Bank Act are preempted. For lending, these types of state laws include those regarding licensing, terms of credit, permissible rates of interest, escrow accounts, disclosures and advertising. For deposit-taking, they include laws on disclosure, licensing, registration, abandoned and dormant accounts, checking accounts and funds availability. ***These areas are fundamental to the conduct of the banking business*** and rightly fall within the authority of federal regulators to determine the appropriate application of federal law to federally chartered depository institutions.

The OCC rule applies to national banks and their operating subsidiaries. Operating subsidiaries are limited to those activities that may be conducted in the bank itself. In practice, operating subsidiaries function as a department of the bank.

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[2] See, e.g., *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 31-32 (1996); *Franklin Nat'l Bank of Franklin Square v. New York*, 347 U.S. 373, 378 (1954); and *Assn. of Banks in Ins. Inc. v. Duryee*, 270 F.3d. 397, 409 (6th Cir. 2001).

We would point out that there has been a great deal of confusion and misinformation over the different types of subsidiaries and rules applicable to each type. Much of the confusion stems from inaccurate statements made by representatives of the real estate industry, so some clarification is in order.

National bank *operating subsidiaries*, under longstanding regulations of the OCC, may engage only in activities authorized to the bank. They are, in effect, separately incorporated departments of the bank.

Another type of national bank subsidiary is the *financial subsidiary*. Financial subsidiaries were authorized by Congress in the Gramm-Leach-Bliley Act to engage in a broad range of financial activities that the bank itself may not engage in. These financial subsidiaries are functionally regulated. OCC's preemption rule does *not* apply to financial subsidiaries.

A third type of subsidiary is a non-bank subsidiary of a bank or financial holding company. These subsidiaries are subject to state regulation and OCC's preemption rule does not apply to them.

The proposal published by the Treasury and the Federal Reserve to authorize real estate brokerage authority would place those activities in ***financial subsidiaries of national banks or holding company subsidiaries, neither of which comes within OCC's preemption rule***. As a result these subsidiaries would be functionally regulated and subject to all state licensing, continuing education and other requirements that apply to all real estate brokers.

Going back to the OCC's rule, it is important to note that it does not preempt ***all*** state banking and financial services laws for national banks as some state organizations have suggested.[3] Rather, state laws that do not affect the conduct of the banking business, such as "infrastructure" laws,[4] are not subject to the preemption rule.

[3] The OCC sought comment on whether it should "occupy the field" (*i.e.,* leave no room for any state regulation) with respect to real estate lending activities based on the broad authority Congress granted to the agency in 12 U.S.C. § 371. The OCC chose, however, to take a more conservative approach.
[4] State infrastructure laws are those laws that do not impact banking activities, *i.e.,* contract, criminal, property and local building and fire codes.

In addition, the OCC's determination remains subject to the notice and comment process of Section 114 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act") for state laws regarding community reinvestment, consumer protection, and fair lending.[5] Contrary to concerns that have been raised, the OCC's action is fully in accord with Congressional intent in Section 114 of the Riegle-Neal Act.[6] That section imposes on the OCC a process for ensuring public comment on requests for preemption of certain types of state consumer protection laws. ***Importantly, that section did not impose or change the standard for preemption determinations.*** Rather, Congress expressly intended that it should incorporate traditional judicial preemption analysis.[7]

Similarly, while the Gramm-Leach-Bliley Act[8] affirmed state authority to regulate insurance activities of depository institutions, it also incorporated the *Barnett* standard and broadly preempted all non-insurance state laws that "prevent or restrict" any depository institution (and their affiliates and subsidiaries) from engaging in activities authorized by the Act.[9]

It is important to note that the OCC's regulation does not differ fundamentally from regulations and determinations made by other regulators of federally chartered depository institutions. For example, the categories of state law preempted by the OCC are substantially identical to those already preempted by the Office of Thrift Supervision (OTS) for federally chartered thrift institutions. In fact, the OCC rule does not go as far as the current preemptive regulations of the OTS and the National Credit Union Administration (NCUA). A comparison of the preemption regulations of the OCC, OTS and NCUA is attached to this statement.

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[5] Pub. L. 103-328, 108 Stat. 2338 (1994).
[6] *Id.*
[7] See, H. Report 103-651, 2d Sess. (1994) at 53. "Accordingly, the title emphasizes that a host state's laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches will apply to interstate branches of national banks established in the host state to the same extent as those laws apply to a branch of a state bank *except when Federal law preempts the application of the State laws to a national bank . . .*" [Emphasis added.]
[8] Pub. L. 106-102, 113 Stat. 338 (1999).
[9] Another concern that has also been raised is whether the OCC's preemption determination ignored the savings provision in the Home Owner's Equity Protection Act of 1994 ("HOEPA"). That provision, which is part of the Truth in Lending Act ("TILA"), applies only to state laws that are inconsistent with HOEPA. Indeed, in American Bankers Association v. Lockyer, a U.S. District Court held that the TILA savings provision does not reach beyond TILA to control the preemption analysis under any other federal law. 239 F. Supp. 2d 1000, 1009 (E.D. Calif. 2002).

II. The OCC's Rule is Fundamental to the Dual Banking System

The dual banking system is a simple, yet powerful concept. It consists of a state chartering and supervisory system for state banks and a federal chartering and supervisory system for national banks. Each relies on state or federal legislation to determine the activities of and regulatory policies for the respective charters. Certainly, many common features are shared by both charters. But the success of the system derives from the healthy differences that historically have driven new product innovation, helped reduce excessive regulatory costs, and enhanced the overall safety and soundness of the banking system.

Preservation of this important and unique system of regulation requires both a strong state system ***and*** a strong national system of chartering and regulation. Federal preemption serves as a check when states pass laws that inappropriately restrict or condition the fundamental activities or operations of federally chartered financial institutions. By contrast, the states are free to amend their laws if they believe that state-chartered institutions are at a competitive disadvantage *vis-à-vis* national banks as a result of preemption.

The areas addressed by the OCC rule – lending and deposit taking – are fundamental to the business of banking. If state laws apply to these most basic activities of national banks, and if states can examine national banks and enforce laws against them, the differences between the two systems would disappear—and so would the dual banking system. Simply put, for a strong national system to exist, state and local governments must not be able to impose material restrictions on the fundamental banking activities of national banks. Thus, the OCC's rule, rather than harming the dual banking system, is necessary to preserve it.

III. The OCC's Preemption of State Laws Will Not Diminish Consumer Protection

Preemption of state laws will not diminish protections for consumers that do business with national banks. Consider the federal consumer protection laws and regulations with which national banks must comply, which include:

- Federal Trade Commission Act
- Truth in Lending Act

- Home Ownership and Equity Protection Act
- Fair Housing Act
- Equal Credit Opportunity Act
- Real Estate Settlement Procedures Act
- Community Reinvestment Act
- Truth in Savings Act
- Electronic Funds Transfer Act
- Expedited Funds Availability Act
- Flood Disaster Protection Act
- Home Mortgage Disclosure Act
- Credit Practices Rule
- Fair Credit Reporting Act
- Federal Privacy Laws
- Fair Debt Collection Practices Act
- OCC anti-predatory lending rules (Parts 7 and 34)
- OCC standards on unfair and deceptive practices
- OCC consumer protection rules for debt cancellation and suspension agreements

The OCC's preemption rule does nothing to diminish this sizable body of federal consumer protection laws. Furthermore, the OCC's rule imposes on national banks a new anti-predatory lending standard to prevent them from making loans based on the value of the collateral rather than the borrower's ability to repay the loan, and to prohibit practices that are unfair or deceptive practices under the Federal Trade Commission Act ("FTC Act").

The OCC has demonstrated its strong commitment to protecting consumers in their dealings with national banks, as evidenced by its promulgation of comprehensive predatory lending advisory letters and vigorous enforcement of unfair or deceptive trade practices. For example, the agency has taken six enforcement actions against national banks under the FTC Act that have generated hundreds of millions of dollars in restitution to consumers. The OCC has also moved aggressively against national banks engaged in payday lending programs, requiring them to terminate relationships with payday lenders.

These enforcement actions further demonstrate that the OCC has the resources to assure compliance with consumer protection laws. In fact, the enforcement resources – ***both in terms of regulatory power and examination capabilities*** – are greater for the OCC with respect to national banks than the resources available to state and local authorities. The OCC employs approximately 1,900 examiners to cover 2,100 national banks. The largest national banks have permanent examiners on site. For example, Bank of America has 40 on-site examiners. All national banks are examined at least once every 18 months, and these examinations include ***both*** safety and soundness and consumer compliance reviews. Clearly, there is no shortage of resources to assure national banks operate safely and soundly, while respecting the rights and needs of consumers.

Unfortunately, there has been misinformation about the OCC's resources emanating from an amendment offered in the House Committee on Financial Services recently. The amendment stated that "[t]here are currently only 40 full-time staff members allocated for [consumer complaints] at the OCC." The amendment goes on to compare this staff of forty to the asserted fact that "state banking agencies and state attorney generals' offices employ nearly 700 full-time examiners and attorneys to monitor and enforce consumer law complaints."

Of course, this comparison to "40" to "700" is apples to oranges. The OCC's consumer enforcement is not limited to forty people at a call center. Moreover, the 700 state individuals mentioned are not devoted solely to addressing consumer issues relating to banks. For example, while the jurisdiction of state banking agencies varies from state-to-state, the state banking agencies regulate well over 100,000 institutions of many different types, from consumer finance companies to check cashers. State attorneys general also have jurisdiction over a broad range of issues, of which banking would be a very small percentage. Thus, rather than a nearly one-to-one relationship between institutions overseen and staff for the OCC, there is a 48-to-1 relationship for institutions overseen at the state level.

Moreover, the ***remedies*** available to the OCC are comprehensive and broader than those available to state and local authorities. For example, a state attorney general may order restitution only to consumers that live in his or her state. By contrast, OCC can require restitution for all of a national bank's customers regardless of where they live. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, the restitution and remedial action ordered by the

OCC was "comprehensive and significantly broader in scope than that available through state court proceedings."[10]

IV. Options Exist to Address Specific Issues without Undermining the Dual Banking System

Much of the debate over the OCC rule has been in the context of the need to address the terrible problem of predatory lending. However, we believe it would be a mistake to undermine the dual banking system in a very broad way because of concerns about an individual issue, even one as important as predatory lending, since there are other, more direct and effective ways to address the problem. As noted above, allowing state and local governments to regulate the most fundamental activities of national banks—in this case lending—would dramatically impact the dual banking system. However, that does not mean that state and local governments should not have a role in addressing any concerns that should arise with respect to predatory lending by national banks (although there has been scant evidence that banks have been a significant problem in the area of predatory lending, as pointed out in the recent court brief signed by nearly two dozen State Attorneys General).[11]

There are, in fact, at least two approaches – not mutually exclusive – to predatory lending that we believe would work well within the context of the dual banking system and without doing damage to that system. The first involves cooperation between the OCC and state and local officials; the second involves targeted federal legislation to address predatory lending practices.

While some have recently questioned the regulatory and enforcement authority and capabilities of the OCC, we believe (as outlined above) that it is quite clear that the OCC does have strong capabilities in regulation and enforcement, including the area of predatory lending. The OCC has the authority to issue regulations in this area (as evidenced by the rule being reviewed here today), has examiners that routinely examine every national bank (and permanently stationed in the larger banks), and has significant enforcement powers to stop any predatory lending practices and provide penalties and restitution.

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[10] *State of Arizona v. Hispanic Air Conditioning and Heating, Inc.,* CV 2000-003625, Ruling at 27, Conclusions of Law, paragraph 50 (2003).
[11] Brief for Amicus Curiae State Attorneys General, *Nat'l Home Equity Mortgage Ass'n v. OTS,* Civil Action No. 02-2506 (GK) (D.D.C.) at 10-11.

To best serve the interests of consumers, we believe that state and local governments should work on an on-going basis with the OCC to identify any problems and recommend any changes in the regulation of national banks that may be necessary to address those problems. The OCC has indicated its strong interest in this kind of cooperation. OCC recently reminded national banks should they receive consumer complaints from state officials that they should deal with the consumer directly to resolve the situation without any need to first notify OCC. Such a complaint referral is not contrary to the exclusive visitorial rule. In addition, should state and local enforcement authorities find specific situations in which national banks are engaging in unethical or illegal activities, they should forward this information directly to the OCC for action. Should such activities be discovered, we are quite confident that the OCC would take strong action against the institution and individuals involved. I am sure Members of Congress would also be interested, given the great concern about predatory lending, in using congressional oversight authority to ensure that the OCC is taking a strong stand.

We believe that this is the way the dual banking system should work. Under this approach, state and local governments would not try to regulate fundamental activities of national banks, and therefore the dual banking system would be maintained. At the same time, any problems that are discovered by state and local enforcement authorities would be addressed by the regulator with the expertise in supervising the national banking system. We believe this is the most efficient use of enforcement resources.

A second approach, which is not inconsistent with the first, is the passage of targeted federal legislation to address predatory lending. There are a number of areas where Congress has determined that a federal approach to a given consumer protection issue is warranted, and the Congress has been able to enact appropriate legislation without undermining the dual banking system. As you know, this is the approach recently taken by the Congress with respect to the Fair Credit Reporting Act.

We do understand that in many ways real estate lending is a local issue, as real estate markets are, by and large, local. However, the huge impact of the secondary market on real estate lending is evidence that a national approach to predatory lending may be the best solution. In fact, several state and local initiatives have immediately run afoul of the national secondary market, with the result that those initiatives had to be changed.

Concerns about predatory lending could be addressed through both these approaches, and we recommend that the Congress actively consider proposals for a national approach to predatory lending.

Conclusion

In conclusion, the ABA believes that the OCC's approach to national standards for national banks and, in particular, predatory lending practices, is a measured one, grounded firmly in traditional judicial preemption doctrine. The OCC's rule preserves national standards for lending and deposit-taking by national banks and strengthens the dual banking system. It eliminates much of the uncertainty for national banks, thereby facilitating better planning and delivery of financial services. Coupled with vigorous enforcement of fair dealing and high ethical standards for national bank lending relationships with consumers, these standards for national banks will ensure that home loans remain available to all consumers and that national banks do not engage in predatory or unfair and deceptive practices.

The ABA appreciates the opportunity to provide our views on this important topic.

Attachment A
Federal Preemption Cases Involving National Banks

1870 – National Bank v. Commonwealth, 76 U.S. (9 Wall) 353. Shortly after the passage of the National Bank Act, the U.S. Supreme Court held that a Kentucky tax on bank shares was not preempted by the National Bank Act. Nonetheless, the Supreme Court stated that national banks are –

> *... exempted from State legislation, so far as legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve...*

1896 – Davis v. Elmira Savings Bank, 161 U.S. 275. A New York State law that established preferences for creditors of an insolvent bank was found to conflict with the terms of the National Bank Act. In its opinion, the Supreme Court noted that national banks are federal instrumentalities, and that state laws that either impair their efficiency or frustrate their authority are void:

> *National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt, by a state, to define their duties or control the conduct of their affairs is absolutely void, whenever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiencies of the agencies of the Federal government to discharge the duties, for the performance of which they were created.*

1903 – Easton v. Iowa, 188 U.S. 220. An Iowa law prohibiting the acceptance of deposits by insolvent banks was found to be incompatible with the system of regulation established by the National Bank Act. In its opinion, the Supreme Court noted that in passing the National Bank Act, Congress created a banking system independent of state legislation:

> *[The National Bank Act] has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation, which, if permitted to be applicable, might impose limitations and restrictions as various and numerous as the States.*

1923 – First Nat'l Bank of San Jose v. State of California et al, 262 U.S. 366. A California statute that provided for the transfer of dormant accounts to the state after a set period of time was found to conflict with the National Bank Act. In its opinion, the Supreme Court again referred to national banks as federal instrumentalities:

> *These banks are instrumentalities of the Federal Government. Their contracts and dealings are subject to the operation of general and undiscriminatory state laws which do not conflict with the letter of the general object and purposes of congressional legislation. But any attempt to define their duties or control the conduct of their affairs is void whenever it conflicts with the laws of the United*

> *States or frustrates the purposes of the national legislation or impairs the efficiency of the bank to discharge the duties for which it was created.*

1954 – Franklin Nat'l Bank v. New York, 347 U.S. 373. A New York law prohibiting the use of the word "savings" in advertisements by certain state and national banks was found to interfere with the enumerated authority of national banks to accept deposits. In its opinion, the Supreme Court noted that the authority of the Federal Government to regulate national banks was settled over 40 years before the passage of the National Bank Act, when the Court held that the states had no power to tax or regulate the Second National Bank of the United States:

> *Since McCulloch v. State of Maryland ... it has not been open to question that the Federal Government may constitutionally create and govern [national banks] within the states.*

1978 – Marquette Nat'l Bank of Minnesota v. First Omaha Services Corp., 439 U.S. 299. A Minnesota usury law was held not to be applicable to national banks. This decision by the U.S. Supreme Court stimulated the development of our national consumer credit system.

1982 – Fidelity Federal Savings & Loan Assn. v. de la Cuesta, 458 U.S. 141. A California law was held not to apply to a due on sale clause used by a federal thrift. While this case involved a federal thrift, the opinion issued by the U.S. Supreme Court stands for the proposition that a federal regulation has the same preemptive effect as a federal statute.

1983 – Conference of State Bank Supervisors v. Conover, 710 F.2d 878. In this case, the U.S. Court of Appeals for the District of Columbia upheld the preemptive effect of a real estate regulation issued by the OCC, citing the Supreme Court ruling in the de la Cuesta case. In so doing, the Court of Appeals emphasized the limitations of state laws on national banks:

> *It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal laws and where such state law does not conflict with the policies of the National Bank Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state law.*

1996 – Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25. A Florida law that prohibited banks from selling insurance was held to conflict with the insurance sales powers of national banks. In its opinion, the Supreme Court stated that state laws that "prevent or significantly interfere" with the authorized powers of national banks are subject to preemption. Congress subsequently included this "prevent or significantly interfere" phrase in the insurance provisions of the Gramm-Leach-Bliley Act.

1996 – Smiley v. Citibank, 517 U.S. 735. A California law was held not to apply to a late payment fee imposed on a credit card loan by an out-of-state national bank. In this case, the U.S. Supreme Court expanded upon its earlier Marquette ruling, concluding that the provision of the National Bank Act related to interest rates also overrides state laws on late payment fees.

1999 – Bank One, Utah, N.A. v. Guttau, 190 F.3d 844 (8th Cir.). An Iowa law restricting the operation of ATMs by out-of-state banks was held to conflict with the National Bank Act. In reaching this decision, the Court of Appeals for the Eighth Circuit favorably cited a statement made by the U.S. Supreme Court in the Barnett case:

> *Grants of both enumerated and incidental 'powers' to national banks [are] grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law.*

2001 – ABIA v. Duryee, 270 F.3d 409 (6th Cir.). An Ohio law that limited the ability of national banks to sell insurance was found to infringe on the powers of national banks. Citing the Supreme Court's decision in the 1944 Anderson case, the U.S. Court of Appeals for the Sixth Circuit noted that –

> *Pre-emption in the area of national banks may occur even if compliance with both state and federal laws is possible where the state laws "infringe the national banking laws or impose an undue burden on the performance of the banks' functions".*

2002 – Bank of America v. City and County of San Francisco, 309 F.3d 551 (9th Cir.). California municipal ordinances that prohibited banks from charging ATM fees to non-depositors were found to intrude on the powers of national banks. In doing so, the U.S. Court of Appeals for the Ninth Circuit noted that –

> *The National Bank Act was enacted to protect national banks against intrusive regulation by the States.*

2003 – Wells Fargo Bank, N.A. v. Demetrios, 265 F.Supp. 2d 1162 (E.D. Cal.). An attempt by the State of California to license and examine a real estate subsidiary of a national bank was found to be contrary to the National Bank Act. In so holding, the U.S. Court of Appeals for the Ninth Circuit affirmed that the preemptive power of the National Bank Act runs not only to a national bank, but also to an operating subsidiary engaged in activities permissible for the parent:

> *Because [Wells' mortgage subsidiary] "is treated as a department or division of its parent [national bank] for regulatory purposes," the Commissioner lacks visitorial power over [the subsidiary] just as it lacks visitorial power over [the subsidiary's] national bank parent.* (Quote from a Wisconsin federal district court case).

In the Wells case, the Court also cited a federal district court opinion (First Union Nat'l Bank v. Burke) to emphasize that federal preemption does not detract from the inherent regulatory powers of the states:

> *Under the national banking regulatory scheme, Congress does not direct the state executive to affirmatively function in any particular way, nor does the OCC's exercise of exclusive visitorial powers over national banks preclude the state statutory enactments from being applied to national banks provided they are not in conflict with and thus preempted by federal banking laws. By creating such a*

> *scheme, Congress has not seized the machinery of state government to achieve federal purposes. The relegation of regulatory and supervisory authority over federal instrumentalities to a single federal regulator does not interfere with the Commissioner's enforcement of state law against state banks, does not interfere with the state's enactment of non-preempted state banking law applicable to national banks, does not preclude the Commissioner from seeing OCC enforcement of state laws, and expressly leaves available judicial remedies to compel national bank compliance with state law.*

2003 – Beneficial Nat'l Bank v. Anderson, 123 S.Ct. 2058. A state law governing claims and remedies related to usury was found to be contrary to the National Bank Act. In reaching this conclusion, the Supreme Court noted that –

> *... this Court has also recognized the special nature of federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system that needed protection from "possible unfriendly State legislation."*

Attachment B
OCC Preemption Rules Are Patterned After Long-Standing OTS and NCUA Preemption Rules

The Office of the Comptroller of the Currency ("OCC") has regulations to preempt state laws affecting the lending and deposit-taking activities of national banks and their operating subsidiaries. The OCC's regulations are patterned after long-standing regulations issued by the Office of Thrift Supervision ("OTS") and the National Credit Union Administration ("NCUA").

Both OTS and NCUA have regulations that broadly preempt specific types of state lending and deposit-taking laws for federal thrifts and federal credit unions. OTS also has extended its preemption regulations to the operating subsidiaries of federal thrifts.

The NCUA regulation preempting state lending laws was adopted almost 20 years ago (see 12 C.F.R. § 701.21(b)). NCUA also has adopted a regulation that preempts state deposit-taking laws (see 12 C.F.R. 701.35(c)).

The current OTS regulation preempting state lending laws has been in effect for over 7 years, and is based upon longstanding legal opinions by both OTS and its predecessor, the Federal Home Loan Bank Board (see 12 C.F.R. §560.2). OTS also has issued a regulation that preempts state deposit-taking laws (see 12 C.F.R. § 557.12).

The following tables compare the OCC's preemption regulations and the existing OTS and NCUA preemption regulations. The first table illustrates the similarities between the types of state laws preempted by the OCC regulations and those preempted by the existing OTS and NCUA regulations. The second table lists the types of state laws that are ***not*** preempted by the OCC regulations and the existing OTS and NCUA regulations, and shows that the OCC regulation expressly preserves more state laws than the existing OTS and NCUA regulations.

Types of State Lending and Deposit-Taking Laws Preempted by the OCC Regulations and the Existing NCUA and OTS Regulations

	OCC	OTS	NCUA
Abandoned and dormant accounts	v	v	v
Aggregate amount of funds that may be lent on the security of real estate	v*		
Checking/share accounts	v	v	v
Covenants and restrictions necessary to qualify leaseholds as security property for a real estate loan	v*		
Credit reports, access to and use of	v	v	
Credit terms	v	v	v
Creditor insurance/credit enhancements/risk mitigants	v	v	
Due-on-sale clauses	v	v	v
Escrow, impound and similar accounts	v	v	
Funds availability		v	
Interest rates and fees	v	v	v
Licensing, registration, filings and reports	v	v	
Loan-to-value ratios	v*	v	v
Mandated statements and disclosure requirements	v	v	v
Mortgage origination, processing and servicing	v	v	
Repayment/disbursement	v*	v	v
Savings account orders of withdrawal	v	v	
Security property, including leaseholds	v	v	v
Special purpose savings services (deposit-taking)	v	v	

* The OCC's existing real estate lending regulation (12 C.F.R. §34) already preempts these categories of state law.

Types of State Laws *Not* Preempted by the OCC Rule and the Existing OTS and NCUA Regulations

	OCC	OTS	NCUA
Collection costs, attorneys' fees			v
Commercial		v	
Contract	v	v	
Criminal	v	v	
Debt collection	v		
Default conditions			v
Homestead (12 USC 1462(a)(f))	v	v	
Incidental effect only	v	v	
Insurance			v
Plain language requirements			v
Real Property	v	v	v
Taxation	v		
Torts	v	v	
Zoning	v		

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JOHN D. HAWKE, JR.

Q.1. Can you provide the Committee a brief overview of how the issue of BSA compliance is handled by your examiners? Specifically, do the examiners look at a general program—a sort of list of activities or programs the bank engages in? Do the examiners ever look at individual transactions to gauge a bank's compliance with the BSA?

A.1. The OCC has a longstanding commitment to combating money laundering. We have always shared the Committee's belief in the importance of preventing the financial institutions we regulate from being used, wittingly or unwittingly, to aid in money laundering and, with the events of September 11, we are now equally vigilant about the need to combat terrorist financing. We remain totally committed to working with the law enforcement community to assist in the investigation and prosecution of organizations and individuals who violate the law and engage in money laundering, terrorist financing, and other criminal acts.

The primary responsibility for compliance with the Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance rests with the Nation's financial institutions themselves—they represent the front lines in the fight against money laundering. The OCC has a statutory mandate to ensure that national banks comply with these laws. Where deficiencies are noted, we take supervisory and enforcement actions to ensure that the bank promptly corrects them.

The OCC conducts regular examinations of national banks and branches and agencies of foreign banks in the United States, covering all aspects of an institution's operations, including compliance with the BSA and review of AML efforts. The OCC monitors compliance with the BSA and money laundering laws through its BSA compliance and money laundering prevention examination procedures. In September 2000, the OCC issued the latest version of the *Comptroller's Handbook for National Bank Examiners* (Handbook) on BSA/AML compliance. The Handbook contains procedures designed to assess BSA compliance as well as identify suspected money laundering. These risk-based procedures were developed by the OCC, in cooperation with the other Federal banking agencies. The Handbook section also contains guidance in a host of key areas such as suspicious conduct and transactions, customer identification, high-risk areas, entities, and countries, and common money laundering schemes. We are presently revising the Handbook and expect that a new version will be issued later in the year. The new Handbook will contain revised examination procedures covering the new regulations issued under the USA PATRIOT Act, as well as updated information and guidance.

Strong internal policies, systems, and controls are the best assurance of compliance with the reporting and recordkeeping requirements of the BSA and the money laundering laws. Consequently, the Handbook's procedures focus our examination efforts on a national bank's system of internal controls, audits, policies, and procedures in the BSA/AML area. Where examiners note control weaknesses or when we receive a lead from a law enforcement or other external source, the examiners are directed to test the bank's policies, systems, and controls by utilizing supplemental procedures and reviewing certain individual transactions.

Combating money laundering depends on the cooperation of law enforcement and regulatory agencies. Therefore, the OCC participates in a number of interagency working groups aimed at money laundering enforcement, and meets on a regular basis with law enforcement agencies to discuss money laundering issues and share information that is relevant to money laundering schemes. Through these interagency contacts, we sometimes receive leads as to possible money laundering in banks that we supervise. Using these leads, we can target compliance efforts in areas where we are most likely to uncover problems. For example, if the OCC receives information that a particular account is being used to launder money, our examiners would then review transactions in that account for suspicious funds movements.

In certain cases where the OCC suspects that serious violations of the BSA or money laundering have occurred, we investigate. Once the FCC opens an investigation, we can use our administrative subpoena power to compel the production of documents and testimony from individuals and entities both inside and outside of the bank. This information is not only used for our supervisory purposes, but also , when it is relevant to a potential criminal violation, it is shared with the appropriate criminal law enforcement agencies. We also provide the proper State and Federal governmental authorities with active assistance as well as documents, information, and expertise that are relevant to their money laundering investigations. The OCC has conducted several investigations into suspected money laundering activities, and we continue to closely cooperate with Federal criminal law enforcement agencies. These investigations may result in both criminal convictions and significant asset forfeitures. In addition, the OCC possesses broad enforcement authority, including the power to issue cease and desist orders, civil money penalties, and removals of bank officers, directors, and other institution-affiliated parties. From 1998 to 2003, the OCC has taken a total of 38 enforcement actions based, in whole or in part, on BSA/AML violations.

All banks are required by regulation to report suspected crimes and suspicious transactions that involve potential money laundering or violate the BSA. In April 1996, the OCC, together with the other Federal financial institution regulatory agencies, and the Financial Crimes Enforcement Network (FinCEN), unveiled the suspicious activity reporting system, suspicious activity report (SAR) form, and database. This system provides law enforcement and regulatory agencies online access to the entire SAR database. Based upon the information in the SAR's, law enforcement agencies will initiate an investigation and, if appropriate, take action against violators. By using a universal SAR form, consolidating filings in a single location, and permitting electronic filing, the system greatly improves the reporting process and makes it more useful to law enforcement and to the regulatory agencies. As of June 2003, banks and regulatory agencies had filed over 1.1 million SAR's, with national banks by far the biggest filers. Nearly 50 percent of these SAR's were for suspected BSA/money laundering violations.

The OCC also uses the SAR database as a means of identifying high-risk banks and high-risk areas within banks. In addition, the OCC uses the SAR database to identify potential cases against bank insiders and employees for administrative enforcement actions. For example, since 1996, through our review of SAR's and its predecessor, the criminal referral form, the OCC has prohibited hundreds of individuals from participating in the banking industry.

In 1997, the OCC formed an internal task force on money laundering called the National Anti-Money Laundering Group (NAMLG). The purpose of the NAMLG is to serve as the agency's focal point for BSA/AML supervision. Through the NAMLG, the OCC has embarked on several important projects.

One major project of the NAMLG involves the targeting of banks that may be vulnerable to money laundering for examinations using expanded-scope procedures. We select banks for these examinations based on law enforcement leads or criteria developed by the OCC. Through the years, we have conducted over 70 expanded-scope AML examinations based on law enforcement leads and other criteria.

The NAMLG has developed guidance to assist our examination staff in targeting institutions that might be vulnerable to attempts by individuals or institutions to engage in money laundering activities. The guidance sets forth a series of factors in developing a prioritized list of institutions that are considered most susceptible to money laundering. Some of the factors are the extent of funds transfers to or from entities in foreign countries that are believed to be money laundering havens; the extent of account relationships with individuals and entities located or otherwise associated with the above-referenced countries; the strength of the bank's BSA/AML program and monitoring mechanisms; and other factors which may make the bank susceptible to money laundering.

The NAMLG has also worked with law enforcement agencies and the other regulatory agencies to develop an interagency examiner training curriculum that includes training on common money laundering schemes. We are also continuing to work with the other Federal banking agencies on new examination procedures to address the USA PATRIOT Act requirements and ensure that they are effective in identifying potential money laundering activities.

Other responsibilities of the NAMLG include sharing information about money laundering issues with the OCC's District offices; analyzing money laundering trends and emerging issues; and promoting cooperation and information sharing with national and local anti-money laundering groups, the law enforcement community, bank regulatory agencies, and the banking industry.

The OCC believes that interagency coordination and cooperation are critical to successfully addressing BSA and money laundering issues. We actively participate in several interagency groups seeking to curtail money laundering through financial institutions by surfacing issues, sharing information, and making recommendations to improve money laundering enforcement and awareness. These include the BSA Advisory Group, chaired by the U.S. Treasury Department, which is composed of policy, legal, and operations representatives from the major Federal and State law enforcement and regulatory agencies involved in the fight against money laundering, as well as industry representatives, and the National Interagency Bank Fraud Working Group, of which we have been a very active member since its founding in 1984. We also work on an international basis with the Financial Action Task Force, an intergovernmental body whose purpose is the development and promotion of policies to combat money laundering. In addition, we have participated in various State and Treasury Department missions to assist foreign governments in their anti-money laundering efforts. We expect that these international efforts will continue.

Since passage of the USA PATRIOT Act in 2001, the OCC has been heavily involved in several interagency work groups tasked with writing regulations to implement the new law. These work groups have issued final rules implementing Sections 313/319(b) (foreign shell banks), 314 (information sharing), and 326 (customer identification) (the OCC was the lead drafter of the customer identification rule). We were also involved in drafting the interim final rule implementing section 312 (foreign private banking and correspondent banking). Now that the new regulations are in place, the OCC is using the specialized procedures that we have developed with the other Federal banking agencies in our examinations to ensure that banks are complying with the new requirements.

As mentioned above, the primary responsibility for ensuring that banks are in compliance with the law remains with the bank's management and its directors. To aid them in meeting this responsibility, the OCC devotes time to educating the banking industry about its responsibilities under the BSA. In past years, this has included active participation in conferences and training sessions across the country. For example, in 2002 the OCC sponsored a nationwide teleconference to inform the banking industry about the USA PATRIOT Act. We will continue to be active in this area.

The OCC also provides guidance to national banks through: (1) periodic bulletins that inform and remind banks of their responsibilities under the law, applicable regulations, and administrative rulings dealing with BSA reporting requirements and money laundering; (2) publication and distribution of a guide in this area entitled *Money Laundering: A Banker's Guide to Avoiding Problems;* (3) publication and distribution of the Handbook section; and (4) periodic alerts and advisories of potential frauds or questionable activities, such as the alerts on unauthorized banks.

Q.2. Has Riggs met the deadlines established in the Order? Are you satisfied with their progress to date?

A.2. Because our answer to this question would entail disclosure of confidential supervisory information involving an open bank, it would be inappropriate to respond in this context. Our staff has briefed members of the Committee staff and would be willing to do so again if it would be useful to the Committee. Please be assured, however, that Riggs continues to receive a great deal of scrutiny from this office. We are continuing to closely monitor the corrective action that the bank has taken in response to the Order, and we are prepared to take additional actions if necessary.

Q.3. Given the emphasis on the SAR as a tool that would allow bank examiners and others in the Government to gauge whether the integrity of the banking system is being exploited by criminals and terrorists, is the OCC adequately resourced, trained, and staffed to examine the banks under your jurisdiction to fully inspect their compliance with the BSA?

A.3. Yes, we believe that we have adequate and properly trained staff to fulfill our responsibilities. We also recognize that maintaining an adequate number of staff, with appropriate training to maintain a high level of expertise, is an ongoing challenge. The OCC has approximately 1,700 field examiners that are involved in conducting examinations of national banks. Many of these examiners are not only responsible for assessing safety and soundness, but also compliance with applicable laws including the BSA. We also have BSA/AML specialists in our Washington, DC headquarters office. In addition, the OCC has a full-time examiner in the Offshore Banking and Fraud Unit in Washington, DC, who is responsible for tracking the activities of offshore shell banks and other types of suspicious activities that may be designed to defraud legitimate banks and the public. Over the years, this unit has issued hundreds of industrywide alerts involving unauthorized banks, some of which are suspected of being money-laundering vehicles.

With respect to training, OCC AML training is considered the best in the regulatory industry. In fact, the World Bank recently contracted with the OCC to tape our international BSA school for worldwide broadcast. We conducted AML training for foreign bank supervisors (examiners) two to three times per year for the past 4 years (over 250 foreign supervisors). And we partnered with the State Department to provide AML Training to high-risk jurisdictions, including selected Middle Eastern countries. We consistently provide instructors to FFIEC schools, which are now patterned after the OCC's school. OCC AML schools have trained over 600 OCC examiners over the past 5 years.

Q.4. You have recently named Mark Levonian as the Deputy Comptroller for Modeling and Analysis, a new position. Do you see his duties as including a quantitative analysis of the risk created within the banking community for failure to comply with BSA requirements? Better explained, will he create models, which will allow the OCC and others within the Government to focus limited resources by using models to identify banks, which are most at risk to be used for illicit purposes?

A.4. No, Mr. Levonian was hired by the OCC because of his expertise in modeling various financial risks in banking, that is those associated with credit risk, derivatives, interest rate risk, etc. He will head a group within our Economics Department that provides expertise on modeling financial risk issues to our examiners.

However, identifying banks having higher risk profiles with respect to the BSA may also be addressed with qualitative assessments, and we are experimenting with some judgmental models in this regard. By doing so, we hope to make the most productive use of our resources, as well as identify banks with higher potential for BSA/AML problems. These judgmental models consider high-risk factors such as:

- Bank transactions with countries considered to be bank secrecy havens, drug source countries with stringent financial secrecy laws, or emerging countries seeking hard currency investments.
- Banking activity in high-intensity drug trafficking areas (HIDT A) or high-intensity money laundering and related financial crime areas (HIFCA).
- Transactions with cash intensive businesses such as currency exchange houses, money transmitters, check cashing facilities, convenience stores, restaurants, retail stores, or parking garages.
- Products and services related to the transfer of money, such as remittances, wire funds transfer, pouch activity, international correspondent banking relationships, payable through accounts, international brokered deposits, or special use accounts.
- Foreign private banking, foreign correspondent accountholders, or politically exposed persons (PEP's).
- Excessive currency flows (currency flows between the Federal Reserve Banks and depository institutions).
- Unusual suspicious activity reporting patterns.
- Unusual large currency transaction reporting patterns.
- Information from law enforcement.

The OCC is committed to preventing national banks from being used to launder the proceeds of the drug trade and other illegal activities. With these, and other AML initiatives, active interagency working groups, increased international cooperation, and a committed industry, the OCC intends to make substantial additional progress in preventing the Nation's financial institutions from, wittingly or unwittingly, being used to launder money and engage in terrorist financing. We stand ready to work with Congress, the other financial institution regulatory agencies, the law enforcement agencies, and the banking industry to continue to develop and implement a coordinated and comprehensive response to the threat posed to the Nation's financial system by money laundering and terrorist financing.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM JOHN D. HAWKE, JR.

Q.1. A critical issue raised during the Senate Banking Committee hearing on April 7 involved the extent to which national banks and their State-chartered operating subsidiaries are engaged in predatory lending practices. In order to begin to develop a basis for reviewing this question, please provide the Committee with a list containing the names of all operating subsidiaries engaged in subprime mortgage lending, their location, and parent bank. The Committee would like to receive this information by the end of May.

A.1. The attached table lists the names of national bank operating subsidiaries, their location, and their parent bank. A version of this table is available on the OCC's website at *www.occ.treas.gov/OpSublist.pdf.* This list includes operating subsidiaries that do business directly with consumers, the activities of which are not functionally regulated by another regulator. (Many other operating subsidiaries are engaged in activities such as securities brokerage and insurance sales, which cause them to be "functionally regulated" by securities or insurance regulators, rather than the OCC, pursuant to the Gramm-Leach-Bliley Act.) Operating subsidiaries marked in red text are engaged in subprime mortgage lending.

Q.2. I would like to ask about the application of your preemption standard to State antidiscrimination laws. It is my understanding that you have taken the position, in response to questions submitted to you by Reps. Kelly and Gutierrez, that "State antidiscrimination laws are not preempted by the regulations. The rule only preempts those types of State laws pertaining to making loans and taking deposits that appear on the list contained in the rule . . . Any question about the applicability of a particular State antidiscrimination law would be dealt with on a case-by-case basis, applying the "obstruct, impair, or condition' analysis."

I would like to ask you how that would work in practice. For example, the State of Michigan has an antidiscrimination/antiredlining law that prohibits State or federally chartered banks and other lenders from denying a loan or varying the terms of the loan contract (interest rate, term of maturity, or the percentage required for a downpayment) due to racial or ethnic characteristics or trends of a neighborhood.

Among other things, the law requires the lender to make available for public distribution at the home location and at each branch a pamphlet or document explaining in general terms the lender's criteria for the approval or denial of a loan application. The pamphlet must prominently state that a person has the right to make a loan inquiry and file a written application for a mortgage or home improvement loan and receive a written response to the application. The law also requires the institution to retain for 25 months after the application is submitted a complete record of each loan application, its disposition, and any other documents relating to the application. Would the Michigan antidiscrimination law be preempted in whole or part under the OCC regulation? Why? Would the general prohibition on varying the loan terms based on the racial or ethnic composition of a neighborhood be preempted? Why? Would the requirement that lenders make a pamphlet available explaining the general terms of the lender's criteria for approval or denial of a loan application be preempted? Why? Would the record retention requirement be preempted? Why?

A.2. The preemption rule adds provisions to our regulations expressly addressing the applicability of certain types of State laws to national banks' lending and deposit-taking activities. The listed types of laws are ones that already are preempted under long-standing, preexisting OCC regulations, have been found to be preempted in OCC preemption opinions, have been found to be preempted by the courts, or have been determined to be preempted for Federal thrifts by the Office of Thrift Supervision. Thus, they are types of laws for which substantial precedent exists recognizing the interference they pose to the ability of federally chartered institutions to operate under uniform Federal standards.

The regulation only preempts the types of laws that are *listed* in the regulation. State antidiscrimination laws are not listed in the regulation. We evaluate laws not listed in the regulation under the preexisting, judicially established standards for Federal preemption. Under existing judicial precedent, laws that prohibit the denial of a loan or the variance in loan terms based on the racial or ethnic characteristics or trends of a neighborhood would not be preempted.

For example, in *National State Bank* v. *Long,* 630 F.2d 981 (3d Cir. 1980), the U.S. Court of Appeals for the Third Circuit was asked to consider whether a New Jersey antiredlining statute similar to the Michigan statute you describe was preempted by Federal banking laws. The New Jersey law prohibited geographic discrimination; required lenders to compile and disclose to the public statistical information concerning the number and amount of mortgages originated or purchased annually and the locations of the properties; and authorized the New Jersey Banking Commissioner to bring enforcement actions against lenders that violated the statute. The Court held that insofar as the New Jersey statute required disclosure of mortgage statistics, it was preempted by the Federal Home Mortgage Disclosure Act of 1975.[1] The Court also determined that the antidiscrimination provision of the New Jersey law was not preempted, however. Finally, the Court held that the statute could be enforced against national banks by the OCC, but not by State officials.

As the *Long* case demonstrates, whether the portions of the Michigan statute that do not concern redlining are preempted depends on whether they conflict with Federal law. The record retention requirement in the Michigan statute appears not to be an issue because it is substantially similar to the record retention requirements of the Equal Credit Opportunity Act (ECOA).[2]

Whether the Michigan statute's requirement that a lender make available a pamphlet explaining the lender's loan approval criteria is preempted would depend on its specifics. If the pamphlet requirement is essentially a precondition to making the loan, the requirement would be preempted under the judicial precedent embodied in *American Bankers Ass'n* v. *Lockyer,* 239 F.Supp.2d 1000 (E.D. Cal. 2002), in which the Court considered whether a California law requiring lenders to make certain disclosures in connection with credit card lending was preempted for national banks and other federally chartered lenders. The California law's required disclosures were found by the Court to limit a national bank's power to establish the terms and conditions of credit as well as manage its credit accounts, and the Court held that it was preempted by the National Bank Act and OCC regulations. Our recently enacted regulation, at 12 CFR § 34.4(a)(10) codifies a position on preemption of disclosure requirements that is consistent with the holding of the Court in *Lockyer.*

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM JOHN D. HAWKE, JR.

Q.1. Have you analyzed whether State-chartered institutions in States with "wild card" statutes will be able to operate under the new OCC preemption rules? If you have not, I would ask that you conduct a survey of how many States have such statutes, and what

[1] 12 U.S.C. §§ 2801–2809 (1976).
[2] 12 CFR § 202.12.

effect those provisions would have in terms of numbers of institutions potentially covered by the rule.

A.1. Many States have wild card statutes, which vary in their scope and implementation. Some arguably pertain to permissible activities, and some wild card statutes require the State banking commissioner (or the equivalent official) to trigger their application. In general, this information is contained in the 2002 Conference of State Bank Supervisors publication, Profile of State Chartered Banking. We attach copies of the relevant pages from that publication. For more detail on how the statutes are administered, we would defer to the CSBS and the individual States.

Some States also have adopted parity or "wild card" statutes for specific activities. For example, we are aware of three State predatory lending laws that exempt State institutions in the event that the State law is preempted with respect to federally chartered institutions:

Colorado: Any provision of Colorado's Act Concerning Protection of Consumers' Home Ownership Equity that is preempted by Federal law with respect to a national bank or Federal savings association shall also, to the same extent, not apply to an operating subsidiary of a national bank or Federal savings association, nor to a bank chartered under the laws of Colorado or any operating subsidiary of such a State chartered bank.[1]

Georgia: State banks, trust companies, savings associations, credit unions, and their respective subsidiaries are exempt from the Georgia Fair Lending Act (GFLA) if Federal law preempts or has been determined to preempt the application of the GFLA to any federally chartered bank, trust company, savings association, or credit union. Such Federal preemption shall apply only to the same type of State-chartered entity as the federally chartered entity affected.[2] There is legislation currently pending that would repeal this provision.[3]

Wisconsin: State-chartered banks, trust companies, savings and loans associations, savings banks, credit unions, and their respective subsidiaries are exempt from the Wisconsin statute to the extent Federal law preempts or prohibits the application of the statute to federally chartered banks, trust companies, savings and loans associations, savings banks, credit unions, and their respective subsidiaries.[4]

In addition, in January 2004, **New Mexico** issued a regulation to ensure that all New Mexico-chartered banks have the same powers and authority as federally chartered savings associations.[5]

Q.2. I am interested in hearing more about how the wording in the national bank charter differs from that of the Federal thrift or credit union charters. My understanding is that the national bank charter does not grant "field preemption" to the OCC. Leaving aside whether the OCC has exceeded its preemption authority in the current instance, would you please provide examples of, in your

[1] Colo. Rev. Stat. § 5–3.5–303(2).
[2] Ga. Code Ann. § 7–6A–12.
[3] Ga. House Bill 1171, § 6.
[4] 2003 Wisconsin Act 257 (to be codified at Wis. Stat. § 428.211).
[5] 12.16.76.9 NMAC.

view, what would be permitted under a field preemption standard that is not available to the OCC under its charter?

A.2 State laws are preempted by Federal law, and thus rendered invalid with respect to federally chartered entities (for example, national banks, Federal thrifts, and Federal credit unions) by operation of the Supremacy Clause of the U.S. Constitution.[6] The Supreme Court has identified three ways in which this may occur. First, Congress can adopt express language setting forth the existence and scope of preemption.[7] Second, Congress can adopt a framework for regulation that "occupies the field" and leaves no room for States to adopt supplemental laws.[8] Third, preemption may be found when State law actually conflicts with Federal law. Conflict will be found when either: (i) compliance with both laws is a "physical impossibility;"[9] or (ii) when the State law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[10]

The OTS has issued regulations asserting that it "occupies the field" of deposit-taking and lending regulation for Federal thrifts.[11] But the OTS rule carves out of this regulatory field a number of State laws. Thus, despite its declared intention, the OTS rule does not appear to reflect full field preemption.

If it did, one might expect the result that no State law affecting deposit-taking or lending would apply to Federal thrifts, regardless of how attenuated the law's relationship is to those core activities. Instead, the OTS has listed in its regulations types of State laws that generally do apply to Federal thrifts.

In our preemption rulemaking, the OCC considered whether to adopt an occupation of the field approach to the applicability of State law in the real estate lending area. We concluded that the statutory authority provided to the OCC by 12 U.S.C. §§ 93a and 371 was comparably broad to the OTS's statutory authority, but we declined to assert occupation of the field with respect to national banks' real estate lending activities. Rather, our preemption rule lists particular types of State laws that are preempted with respect to national banks in the deposit-taking and lending areas (including real estate lending). Separately, it lists types of State law that generally are not preempted. Under an unqualified field preemption approach, laws on this second, not-preempted list would likely be preempted, as would a number of other types of State laws ranging from State unfair and deceptive practices statutes to mortgage recordation requirements.

Under the OCC's preemption rule, questions about the applicability of State laws that are not listed as preempted will be resolved by applying the same substantive, Constitutional standards—as articulated by the Supreme Court and lower Federal

[6] "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, anything in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

[7] *See Jones* v. *Rath Packing Co.,* 430 U.S. 519, 525 (1977).

[8] *See Rice* v. *Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947).

[9] *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 143 (1963).

[10] *Hines* v. *Davidowitz,* 312 U.S. 52, 67 (1941); *Barnett Bank of Marion County, N.A.* v. *Nelson,* 517 U.S. 25, 31 (1996) (quoting *Hines*).

[11] Although the OTS asserts in its rules that is occupies the field of lending and deposit-taking regulation for Federal savings associations, its

courts—that have governed preemption analysis since the inception of the national bank charter.

Q.3. Do you support efforts to craft a Federal predatory lending law? If not, why not? Would your position change if the OCC rule is upheld by the courts?

A.3. As we have said repeatedly, predatory and abusive lending practices are inconsistent with national objectives of encouraging homeownership and community revitalization, and can be devastating to individuals, families, and communities. Our Advisory Letters on predatory lending,[12] our pioneering enforcement actions resulting in substantial restitution to affected consumers, together with the new anti-predatory lending provisions in the preemption rule demonstrate that we do not tolerate abusive or predatory lending practices by national banks or their operating subsidiaries.

The key issue in any effort to develop new Federal anti-predatory lending legislation is whether the legislation could be crafted to target predatory lending *practices* effectively without materially reducing availability of non-predatory, but risk-priced subprime credit. Our support for such legislation would not depend on whether our rule, if challenged, is upheld by the Federal courts, but on whether the legislation achieves that goal.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MILLER FROM JOHN D. HAWKE, JR.

Q.1. Mr. Hawke, I understand the Georgia State Banking Commissioner wrote to you on August 21, 2003, requesting clarification on several matters relating to the OCC's preemption of the Georgia predatory lending statute. And my staff person had contacted your staff people around the middle of February—after your rule was released—about getting a response for Commissioner Sorrell. Your staff kept delaying us. Finally, your response came to Commissioner Sorrell on April 2, 2004. Please tell me why it took such a long time to respond to Commissioner Sorrell?

A.1. The OCC issued its Preemption Determination and Order concerning the Georgia Fair Lending Act (GFLA)[1] in late July 2003, and at the same time we proposed the adoption of the preemption rule. The proposed rule raised the possibility that the answers to Commissioner Sorrell's questions would be affected by the final preemption rulemaking. For this reason, we initially delayed responding to Commissioner Sorrell's inquiry pending the adoption of the final rule.

Following the adoption of the final rule,[2] on January 8, 2004, First Senior Deputy Comptroller and Chief Counsel Julie Williams wrote to Commissioner Sorrell. Ms. Williams apologized for the delay in responding and explained that because we had been deliberating the final form of the rule, and because its final form could have superceded Commissioner Sorrell's questions concerning the Preemption Determination, we had concluded that it was best to resolve our rulemaking before responding to his inquiry. Because

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[12] *See* OCC Advisory Letter 2003–2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices" (Feb. 21, 2003) and OCC Advisory Letter 2003–3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans" (Feb. 21, 2003).

[1] 68 Fed. Reg. 46264 (July 30, 2003).

[2] 469 Fed. Reg. 1904 (January 13, 2004).

the rulemaking had been resolved, Ms. Williams assured Commissioner Sorrell that we would then review his questions in light of the final regulation and respond to them.

From that point, unfortunately, the press of work resulted in delays that we regret. On March 16, 2004, the Comptroller sent a letter of further apology to Commissioner Sorrell. Sixteen days later, we provided our full response to the Commissioner.

Q.2. Mr. Hawke, my Georgia Banking Commissioner tells me that the reason the States are so upset with your rule—very simply is that they feel the OCC is making new Federal law and a major public policy change, sweeping aside State laws as they apply to national banks and national bank subsidiaries, without Congressional action and without a public debate. The States are not concerned about a Federal law written by Congress that applies uniformly across the country, but the States are greatly concerned where an unelected Federal regulatory agency is expanding its authority without Congressional authorization. They think your unauthorized rule damages the dual banking system across all States.

Please tell me why the OCC decided to adopt its broad reaching rule without a public debate on the issue before Congress since the rule was rigorously and unanimously opposed by the Nation's governors, State legislators, attorneys general, State bank supervisors, and consumer organizations who all urged public debate and Congressional review? Where do you derive your specific authorized regulatory authority to do this?

A.2. To begin, it is useful to review our reasons for adopting the rule. As you point out, many commenters opposed the rule and suggested that the OCC should have waited longer before finalizing our rules. Please be assured that we considered these comments and timing concerns carefully, but we ultimately concluded that taking action, following a formal rulemaking process, was both respectful of the role of Congress and the course most consistent with our responsibilities as supervisors of the national banking system.

We reached this conclusion for several related reasons. First, the laws under which we acted exist today, and the principles incorporated in our preemption regulation are not new. Precedents of the Supreme Court dating back to 1869 have addressed preemption in the context of national banks and have consistently and repeatedly recognized that national banks were designed by Congress to operate, throughout the Nation, under uniform, federally set standards of banking operations.[3] As a result, there is an extensive body of Federal court precedents that reiterate and apply preemption principles to a variety of different types of State laws.[4] Yet, banks

[3] *See Barnett Bank* v. *Nelson,* 517 U.S. 25, 31–37 (1996) (reviewing and relying on prior national bank preemption cases).

[4] *See, e.g., Bank of America* v. *City & County of San Francisco,* 309 F.3d 551 (9th Cir. 2002), *cert. denied,* 123 S. Ct. 2220, 2003 U.S. LEXIS 4253 (May 27,2003) (the National Bank Act and OCC regulations together preempt conflicting State limitations on the authority of national banks to collect fees for the provision of electronic services through ATM's; municipal ordinances prohibiting such fees are invalid under the Supremacy Clause); *Wells Fargo Bank, Texas, N.A.* v. *James,* 321 F.3d 488 (5th Cir. 2003) (Texas statute prohibiting certain check cashing fees is preempted by the National Bank Act); *Metrobank* v. *Foster,* 193 F.Supp. 2d 1156 (S.D. Iowa 2002) (national bank authority to charge fees for ATM use preempted Iowa prohibition on such fees). *See also Bank One, Utah* v. *Guttau,* 190 F.3d 844 (8th Cir. 1999), *cert. denied sub nom Foster* v. *Bank One, Utah,* 529 U.S. 1087 (2000) (holding that Federal law preempted Iowa restrictions on ATM operation, location, and advertising).

increasingly have been forced to litigate—sometimes repeatedly on the same issue—to clarify the applicability of specific types of State laws, and the OCC has issued separate legal opinions that address the applicability of State law. As national banks operate in an increasingly complex and multi-State environment, the shortcomings of this expensive and time-consuming case-by-case approach have become increasingly apparent. In addition, the financial and opportunity costs to banks of a case-by-case approach may be significant—especially where repetitive litigation becomes necessary to establish clear standards.

Rather than continuing to address preemption issues on a piecemeal basis, the preemption rules address them collectively—by clarifying and codifying prior judicial and OCC interpretations based on long-established Constitutional principles—to provide clear ground rules for national banks concerning the applicability of specified types of State laws. This has become more important in recent years as markets for credit, deposits, and many other financial products and services are have become national, if not international. Now, more than ever before, the imposition of an overlay of 50 State and an indeterminate number of local standards and requirements on top of the Federal requirements and OCC supervisory standards to which national banks already are subject has costly consequences that can materially affect a national bank's ability to serve its customers.

Second, the continuing uncertainty about the applicability of State laws has already negatively affected national banks' ability to lend in certain markets and to access the secondary market, a curtailment of their business that is not only inconsistent with their federally authorized powers but also one that has the potential to adversely affect credit availability. It is worthy of note that recently Standard & Poor's announced it will now require significant additional credit support for certain loans governed by anti-predatory lending laws that are included in its rated transactions in order to address the effect of the potential damages associated with these loans. [5] Some industry analysts have interpreted this action to mean that loans subject to these State laws will not be viewed favorably in securitization pools.[6] Without a certain secondary market for these loans, banks making risk-priced loans covered by this type of State law will be required to hold more of these loans to maturity. This, in turn, ties up more of a bank's capital as it carries the mortgage assets on its books, and thus adversely affects the ability of the bank to originate or acquire other real estate loans.

Moreover, we believed that the *addition* of anti-predatory lending standards to our lending rules materially *reinforces* national banks' obligation to operate pursuant to the highest standards of integrity. Delaying the implementation of those standards was, accordingly, inconsistent with our responsibility to ensure that national banks satisfy those obligations.

[5] Standard & Poor's Implements Credit Enhancement Criteria and Revises Representation and Warranty Criteria for Including Anti-Predatory Lending Law Loans in U.S. Rated Structured Finance Transactions (May 13, 2004).

[6] American Banker, *Predator Laws: S&P's Awkward Position* (May 18, 2004).

With this background, your question raises several important issues. Your question suggests that the preemption rule is a dramatic expansion of preemption. We believe it is not. The preemption rule adds provisions to our regulations expressly addressing the applicability of certain types of State laws to national banks' *lending and deposit-taking activities.*[7] The rule only preempts the types of laws concerning deposit-taking and lending that are listed in the regulation. The listed types of laws are ones that already are preempted under longstanding, preexisting OCC regulations, have been found to be preempted in OCC preemption determinations, have been found to be preempted by the courts, or have been determined to be preempted for Federal thrifts by the OTS. Thus, they are types of laws for which substantial precedent exists recognizing the interference they pose to the ability of federally chartered institutions to operate under uniform Federal standards.

For the many types of laws that are not listed in the regulations, the OCC will continue to evaluate whether such laws are preempted under the preexisting, judicially established standards for Federal preemption that are summarized by the "obstruct, impair, or condition" phrasing contained in the rule. This phrase does not itself preempt any State law; rather we intended it simply to distill the standards that we believe the courts would look to in deciding questions of preemption for the types of laws *not listed* in the regulation.

Third, you question the OCC's authority to adopt the preemption rule. Federal law authorizes the OCC to issue rules that preempt State law in furtherance of our responsibility to ensure that national banks are able to operate to the full extent authorized under Federal law, notwithstanding inconsistent State restrictions, and in furtherance of their safe and sound operations. The deposit-taking and non-real estate lending provisions in the preemption rule are authorized by 12 U.S.C. § 93a, which authorizes the OCC "to prescribe rules and regulations to carry out the responsibilities of the office." The real estate lending provisions are authorized by Section 93a and by l2 U.S.C. 371(a), which authorizes the OCC to "prescribe by regulation or order" the "restrictions and requirements" on national banks' real estate lending power without State-imposed conditions. The U.S. Court of Appeals for the D.C. Circuit recognized that these statutes give the OCC authority to issue regulations with preemptive effect. Over 20 years ago, the Court said:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of State law only in the absence of Federal law and where such State law does not conflict with the policies of the National Banking Act. So long as he does not authorize activities that run afoul of Federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent State laws.[8]

Fourth, you note others have expressed concern that the preemption rule may damage the dual banking system. Frankly, this contention is surprising, since, far from damaging the dual banking system, the rule is fully consistent with it. Distinctions between State and Federal bank charters, powers, supervision, and regula-

[7] Fed. Reg. 1904 (January 13, 2004).

[8] *Conference of State Bank Supervisors* v. *Conover,* 710 F.2d 878 (D.C. Cir. 1983) (emphasis added).

tion are not contrary to the dual banking system; they are the essence of it. Clarification of how the Federal powers of national banks preempt inconsistent State laws is entirely consistent with the distinctions that make the dual banking system dual.

The national and State charters each have their own distinct advantages. Indeed, today State banking regulators vigorously assert that the State charter is superior, pointing to various considerations, including the difference in assessments paid by State banks compared to national banks. But many national banks engage in multi-State businesses that may particularly benefit from the efficiency of a uniform, nationwide system of laws and regulations. Customers of national banks enjoy protections that are as strong as—and in some cases stronger than—those available to customers of State banks. And they also benefit from the efficiencies of the national banking system, and predictable, uniform, consistent regulation. The dual banking system offers American consumers a choice—those who believe the State system offers greater protections, or desirable variety, are free to make that choice.

Q.3. If you do not know the breadth of national bank operating subsidiary numbers and therefore their activities, why were they included in the rulemaking? Do any of these national bank subsidiaries engage in making subprime mortgage loans and if so are these subprime mortgage loans examined by the OCC?

A.3. The preemption rule made no changes to the OCC's preexisting operating subsidiary rules. The rule covers operating subsidiaries by operation of 12 CFR § 5.34, which provides that national bank operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent banks, and 12 CFR § 7.4006, which provides that State law applies to operating subsidiaries to the same extent as it applies to the parent bank. Finally, 12 CFR § 34.1(b) expressly provides that the OCC's real estate lending rules apply both to national banks and their operating subsidiaries. The rules have contained provisions preempting aspects of State laws with respect to *both* national banks *and* their operating subsidiaries since 1996.

The OCC supervises national banks' compliance with consumer protection laws and anti-predatory lending standards through programs of ongoing supervision tailored to the size, complexity and risk profile of different types of banks, and through targeted enforcement actions. National banks and national bank operating subsidiaries are subject to comprehensive—and in the case of the largest banks, *continuous*—supervision. With a network of approximately 1,700 examiners, the OCC conducts risk-based examinations of national banks and national bank operating subsidiaries throughout the United States. Thus, for example, whether a national bank conducts its mortgage lending business in a department of the bank, in a branch, or in an operating subsidiary, OCC supervision focuses on that line of business wherever the bank conducts it.

The attached table lists the names of national bank operating subsidiaries, their location, and their parent bank. A version of this table is available on the OCC's website at *www.occ.treas.gov/OpSublistpdf.* This list includes non-functionally regulated operating subsidiaries that do business directly with consumers. (Many other operating subsidiaries are engaged in activities such as securities brokerage and insurance sales, which cause them to be "functionally regulated" by securities or insurance regulators, rather than the OCC, pursuant to the Gramm-Leach-Bliley Act) Please refer to our answer to Senator Sarbanes' first question with respect to subprime mortgage lending activity by national bank operating subsidiaries.

Q.4. Mr. Hawke, What is your vision now of the relationship between State and Federal enforcement regulators in enforcing both State and Federal law as financial institutions participate in global and national markets?

A.4. We believe the relationship should be cooperative and respectful, and we welcome the opportunity to work cooperatively with State authorities. Our jurisdiction over national banks and their subsidiaries does not deprive State regulators of a role in protecting consumers in their States. Our rules do not affect the ability of States to regulate or take enforcement action when Federal law authorizes them to do so, for example, in the securities, insurance, and telemarketing areas. Nor do the rules prevent State officials from applying and enforcing generally applicable State laws that do not attempt to control the content or conduct of national banks' banking activities.

We are hopeful that a constructive dialogue will soon emerge with State officials. It makes no sense for the OCC and the States to be locked in some kind of competition to supervise the same institutions when supervisory and enforcement resources are so dear, and, as a result, so many institutions—overwhelmingly nonbanks that probably need it most—may be effectively undersupervised.

The OCC took an important step in the direction of this dialogue in our recent Advisory Letter concerning how national banks and their subsidiaries should handle consumer complaints forwarded by State authorities. We made clear that a complaint forwarded by a State official for resolution did not constitute an illegal "visitation" under the National Bank Act, and that national banks should not cite the OCC's exclusive visitorial power as a justification for not addressing the complaint. Nor should they resist a request from the referring State agency for information on how the complaint was resolved.

We also described how States may refer consumer issues concerning national banks to the OCC, including directly to the Chief Counsel's office, and the special procedures we have set up to handle and track these referrals. By coordinating our resources and working cooperatively with the States, we can maximize benefits to consumers, close gaps between existing consumer protection laws, and most effectively target financial predators. We welcome further dialogue with the States to explore these mutual goals.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM ROY COOPER

Q.1. If I understand your position correctly, you would like Congress, in effect to nullify the OCC preemption rule. What is your position with respect to the preemptive authority of federally chartered thrifts and credit unions? Are you asking Congress to modify those charters to prevent preemption of State consumer protection laws, and if not, why not? What distinctions do you see between national banks and these other federally chartered entities?

A.1. Yes, I believe Congress should nullify the OCC's preemption and visitorial powers rules. The OCC's legal authority differs from that of the OTS and the NCUA. Without conceding that the OTS and NCUA have acted within their authority to preempt State consumer protection laws, their authorizing statutes grants them more explicit authority than the National Banking Act grants the OCC.

I do believe that the OTS and the NCUA are also wrong as a matter of policy, and I would support efforts by Congress to revisit this issue of diminished consumer protection of customers of Federal thrifts and credit unions, as well as national banks.

There is a race to the bottom going on. Because the OTS issued its regulations, the OCC wants to issue its own. Now that the OCC has done it, State banks will want parity and try to obtain exemptions from State predatory lending laws. Once State banks seek parity, then State housing creditors (finance companies) will demand a "leveling the playing field" and come knocking on your doors to seek similar preemptive treatment.

A home is the most important purchase most families will ever make. We should raise the floor when it comes to protecting people from unfair home loans, not race to the bottom. We owe that to consumers who are engaging in some of the most important financial transaction of their lives.

Q.2. Do you support efforts to craft a Federal predatory lending law? If not, why not? Would your position change if the OCC rule is upheld by the courts?

A.2. I support efforts to craft a Federal predatory lending law so long as the law sets a floor, not a ceiling. This is particularly important for protecting people in States that have no predatory lending laws. In other Federal consumer protection efforts effecting real estate, Congress has adopted this philosophy. The Home Ownership and Equity Protection Act (HOEPA), the Real Estate Settlement Procedures Act (RESPA), the Fair Housing Act, the Equal Credit Opportunity Act, the Truth in Lending Act, and the Federal Trade Commission Act all regulate the real estate finance market without broadly preempting comparable State regulations. Predatory lending should be no different.

North Carolina needs to retain its flexibility to legislate according to the local conditions of our real estate and mortgage market. Unlike, for example, the airline industry, which is truly national and therefore more suitable for preemption, real estate is inherently local, and States need to have flexibility to respond to abuses in the local marketplace.

RESPONSE TO A WRITTEN QUESTION OF SENATOR MILLER FROM ROY COOPER

Q.1. Mr. Cooper, give me an idea of what the historical working relationship has been with the OCC and what the current working relationship is with the OCC? Which Federal agencies do you have the best working relationship with and why? Do you think such a relationship is possible with the OCC?

A.1. Historically, my office has not had much interaction with the OCC. The OCC's primary mission is to ensure the safety and soundness of the national banking system. My office does not supervise national banks, and thus we have little regulatory overlap. Our office has historically enforced State consumer protection laws against national banks. The OCC's consumer protection role has been only a secondary and recent development. It was not until 2000 that the OCC even determined it had the authority to apply the unfair and deceptive trade practices standards in the FTC Act against national banks. Over the years, State attorneys general have simply enforced State consumer protection laws against national banks without objection from the OCC.[1]

Unfortunately, since the OCC discovered its consumer protection authority, its involvement with the States has been, for the most part, troubling. In fact, the OCC has halted or interfered with several consumer protection investigations and lawsuits by various State attorneys general against national banks or their operating subsidiaries in the last 3 years.[2] This interference hurts consumers and lends credence to the charge that the OCC is far more interested in protecting national banks than in consumer protection.

The OCC, to my knowledge, has participated in only one significant consumer protection settlement involving Providian Bank in California. The case actually was initiated by a local district attorney who was investigating violations of California's State unfair and deceptive practices law, and the settlement was negotiated by the offices of the district attorney and the California Attorney General, along with the OCC. The OCC helped local and State officials with the case by joining in the investigation and settlement.[3] It is worth noting that the OCC did not oppose the State and local officials' participation or their ability to enforce the agreement. This

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[1] See, e.g., *State of Alaska* v. *First National Bank of Anchorage,* 660 P.2d 406 (Alaska 1982) (holding that the Alaska Attorney General could sue a national bank); *Attornev General* v. *Michigan Nat'l Bank,* 312 N.W.2d 405, 414 (Mich. App. 1981), *overruled on other grounds* 325 N.W.2d 777 (Mich. 1982) (holding that a national bank could be held liable by the Attorney General under State and Federal consumer protection laws related to mortgage escrow accounts); *State of Arizona* v. *Sgrillo and Valley National Bank of Arizona,* 176 Ariz. 148, 859 P.2d 771 (1993); *State of Wisconsin* v. *Ameritech Corp., Household Bank and Household Credit Services,* 185 Wis. 2d 686, 517 N.W.2d 70S (1994), *aff'd* 532 N.W.2d 449 (Wisc. 1995); *State of West Virginia* v. *Scott Runyan Pontiac-Buick. Citizens National Bank. et al.,* 194 W.Va. 770, 461 S.E.2d 516 (W.Va. 1995) (holding that the attorney general had the right to bring a civil action against the financial institutions, including the national bank); *State of Minnesota* v. *U.S. Bancorp., Inc.,* Case No. 99–872 (Consent Judgment, D. Minn. 1999).

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

[3] Another example of the OCC supporting State law enforcement concerns payday lending. My office was concerned about entities engaging in unauthorized payday lending in violation of North Carolina usury law through a subterfuge known as "charter renting." Charter renting is when a payday lender affiliates with a bank in order to benefit from the bank's preemptive authority concerning interest rates. To its credit, the OCC acted on safety and soundness grounds to prevent several national banks from renting their charters to payday lenders.

case is an example of why it is good to have a State-Federal partnership. Yet, had the OCC's recently adopted rules existed in 2001, California's law arguably could have been preempted and neither the district attorney nor the attorney general could have initiated the case, begging the question: Would the OCC have ever brought the case if it had not been initiated by local and State law enforcement? This case underscores my central concern that having 51 cops on the beat is better than having one.

I sincerely wish that the OCC would seek to partner with the States in protecting consumers and solving their problems. The State attorneys general and the OCC share common goals of eliminating unfair and deceptive practices and in assuring a fair and competitive credit marketplace. So it would be far preferable if we acted to complement each other's efforts because there is more than enough work for us all. Consumers need more public officials to enforce the law, not fewer.

The attorneys general have worked well with other Federal agencies in exercising our dual enforcement authority in other areas. My office has an excellent working relationship with the Federal Trade Commission (FTC). The FTC has made a commendable effort to communicate and partner with State attorneys general. We jointly bring lawsuits against scofflaws, participate in common consumer education efforts, cosponsor conferences, share information, and use the FTC's Consumer Sentinel Database. In addition to the FTC, attorneys general have good working relationships with other Federal law enforcement agencies, including U.S. Attorneys, the FBI, the U.S. Postal Inspector, U.S. Customs, and HUD, among others.

My office brought a predatory lending case that underscores how having both State and Federal law enforcement ultimately benefits consumers. In 2001, my office settled predatory lending allegations against The Associates resulting in $20 million in consumer restitution to North Carolinians. A year later, the FTC achieved a national settlement with the same entity for $215 million. While North Carolina and the FTC initiated separate investigations into The Associates' lending practices, we avoided turf battles by consulting with each other regularly. I believe that North Carolina's result helped established a consumer friendly framework for the FTC and the Nation. Instead of competing over jurisdiction, we complemented each other's efforts, and most importantly, protected consumers.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM GAVIN M. GEE

Q.1. Have you analyzed whether State-chartered institutions in States with "wild card" statutes will be able to operate under the new OCC preemption rules? If you have not, I would ask that you conduct a survey of how many States have such statutes, and what effect those provisions would have in terms of numbers of institutions potentially covered by the rule.

A.1. Most "wild card" statutes authorize State chartered institutions to engage in activities that are allowed for national banks and do not preempt State consumer protection laws regarding any activity. While a few States have enacted statutes that preempt their own law if it is preempted for a national bank, it is not something that has been widely adopted. I do not believe that any more States will be adopting those types of statutes because virtually all State consumer protection laws have now been preempted by the OCC. At this point a State would just be giving up its right to protect its consumers by adopting such a provision. Attached is a summary of the wild card statutes that are currently in place.

Q.2. Do you support efforts a Federal predatory lending law? If not, why not? Would your position change if the OCC rule is upheld by the courts?

A.2. If the U.S. Congress wants to craft a uniform Federal predatory lending law we stand ready to help you accomplish that goal. We do not oppose Federal preemption when it is done by elected officials after serious public debate. Remember, though, that the vast majority of institutions in the country do not have to comply with a State or Federal predatory lending law at this point in time. In effect you would be adding a new regulatory burden in States that have been using their unfair and deceptive practices acts effectively to deter predatory lending without adding new burdens to institutions that are not engaged in those types of practices.

An alternative that groups of State regulators are considering is for the States to agree upon, and adopt, a uniform approach to predatory lending.

The Comptroller of the Currency has stepped in and created its own predatory lending standard with no guidance from the U.S. Congress, it has told the States that they have no authority to enforce State consumer protection statutes against national banks and their subsidiaries, and the courts have used the Chevron Doctrine to give the Comptroller unfettered discretion. It is time for Congress to reassert its authority over this agency and restore the balance of power.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MILLER FROM GAVIN M. GEE

Q.1. Mr. Gee, one of the other witnesses says that if States regulate operating subs, these operating subs will simply roll up into the national bank or a Federal thrift to avoid State regulation. Do you think this is a real possibility for the operating subs? And what might be the impact on the State regulatory system?

A.1. There are a number of reasons that a national bank or a Federal thrift may want to engage in certain lending activities through a subsidiary. For example, a national bank may want to avoid branching restrictions by engaging in limited activities across State lines through a subsidiary. A national bank or a Federal thrift may want the benefits of protections provided by a separate corporation afforded through State law to engage in riskier activities without putting the parent corporation in jeopardy.

States have traditionally licensed and regulated these entities. After the sweeping preemption of State law for operating subsidiaries of national banks, we have reason to believe that these entities will now turn in their State licenses and ignore State law. There is no reason to believe that, if these entities were brought back under the scrutiny of the State regulators, they would roll up into the national bank to avoid State regulation. In addition, it is my understanding that the OCC is offering this protection from State oversight to an entity with as little as 25 percent ownership by a national bank. The national bank would have to own 100 percent of the stock in a subsidiary to roll it up into the bank itself.

Q.2. Mr. Gee, give me an historical working relationship has been with current working relationship is with the OCC? Which Federal agencies do you have the best and why? Do you think such a relationship is possible with the OCC?

A.2. There has always been a competitive tension between the OCC and the State banking departments. Unfortunately at the moment, given the OCC's current actions, the impression in the States is that the OCC is using regulatory interpretations to preempt State consumer protection law in order to gain a competitive advantage and bring more institutions under the jurisdiction of the Comptroller. Sweeping aside all State consumer protection laws that "condition" the activities of a national bank and eliminating any State authority over subsidiaries of national banks has done nothing to foster a positive working relationship or trust between the States and the Office of the Comptroller of the Currency.

The State regulators have a good working relationship with the Federal Deposit Insurance Corporation and the Federal Reserve. In 1996, all 50 States signed a nationwide State-Federal supervisory agreement with the FDIC and the Federal Reserve laying out how multi-State, State-chartered banks would be supervised while minimizing the burdens imposed on banks. In Idaho, every safety and soundness examination of every bank is currently conducted jointly with the FDIC or the Federal Reserve.

The sweeping nature of the OCC's recent preemption pronouncements and the absolute disregard for any State authority have made this kind of relationship with the OCC difficult at best. Starting over with a Congressional Review Act repeal of these regulations and having the OCC reach out for serious consultation with State regulators and attorneys general on how consumer protection issues for customers of national banks will be handled would be a good start in repairing the relationship with the States.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM MARTIN EAKES

Q.1. If I understand your position correctly, you would like Congress, in effect, to nullify the OCC preemption rule. What is your position with respect to the preemptive authority of federally chartered thrifts and credit unions? Are you asking Congress to modify those charters to prevent preemption of State consumer protection laws, and if not, why not? What distinctions do you see between national banks and these other federally chartered entities?

A.1. I support efforts in Congress to overturn the OCC's final rule on preemption of State anti-predatory lending laws and on States' visitorial powers. As I stated in my written testimony, I oppose the OCC's actions for four main reasons:

- The OCC's final regulation rolls back State legislation that has curbed abusive lending practices while preserving access to credit. The OCC's action will undermine creative efforts by States to protect their citizens from evolving financial abuses.

- The OCC's final regulation has all but eliminated the essential role that States have played in enforcing State laws against abusive lending by national banks, and particularly, by their operating subsidiaries. Instead of complementing a State's efforts, the OCC seeks to replace them, at a catastrophic cost to American homeowners.
- The OCC has blatantly ignored Congressional directives to refrain from interfering with State efforts to protect its citizens from abusive lending unless the Federal policy interest is clear and the legal basis is compelling.
- The OCC's actions will make the national bank charter a safe haven for abusive lenders, an outcome that is bad for borrowers and bad for banks.

I also do not support the OTS and NCUA rulings that Federal law preempts State predatory lending laws. However, there are distinct differences between the OCC preemption ruling and the OTS and NCUA rulings. Regarding NCUA, credit unions are already strongly regulated. Credit unions are prohibited from charging more than 18 percent interest on loans, and are banned from charging prepayment penalties, among other limits on lending practices. Further, credit unions make up a very small percentage of the overall mortgage lending market in the United States. As such, NCUA's footprint is very limited. The OTS order affects a larger number of institutions, but still a much smaller universe than OCC-regulated institutions.

The OCC's announcement and its subsequent public statements go beyond preemption of State laws. The OCC has shown outright enmity toward anti-predatory lending laws in general. Its specific criticism of the North Carolina law is based solely on poor research that shows the OCC's outright bias against State laws of any sort. In addition, it is the view of many legal commentators that the OCC's preemption order is based on much weaker legal ground than the OTS and NCVA orders. And, the OCC's order reverses decades of its own precedent in using preemption only when a law presents a clear conflict with Federal law or with existing OCC regulations. State anti-predatory lending laws do neither.

The combination of the OCC's very aggressive use of preemption in this case, the complete disregard for the OCC's own precedent and established legal doctrine, and the OCC's misplaced hostility toward anti-predatory lending laws in general—and North Carolina's in particular—led me to take a much stronger stance on the OCC's misplaced use of preemption.

Q.2. Do you support efforts to craft a Federal predatory lending law? If not, why not? Would your position change if the OCC rule is upheld by the courts?

A.2. I have had and continue to have good-faith discussions with those in industry who would like to replace State anti-predatory lending laws with a single Federal standard. I cannot, however, support a law that sets a weak standard and preempts State laws. The progression of State laws makes clear that we are starting to see agreement on certain issues. The flipping standard in the

North Carolina law and others, which requires that lenders provide borrowers in refinance transactions with a reasonable, net tangible benefit, does not evoke much, if any, controversy from lenders, ratings agencies, or other mortgage players.

The standard Congress sets has to be strong, and should be a floor for States, not a ceiling. With a strong Federal standard as a floor, State legislatures will undertake the arduous work of enacting State legislation that is often opposed by large industry players only when absolutely necessary to address problems unique to that State. States must retain the flexibility to deal with new abuses that may crop up in their jurisdictions. Congress does not have the ability to foresee local abuses that lurk just around the corner. As such, Congress should not deny States the ability to act to protect its citizens.

Because the courts give great deference to the actions of Federal agencies, I assume the courts may uphold the OCC's decision. That result does not mean that the OCC's recent actions represent good policy. A Federal law that sets a floor, that sets explicit boundaries for the OCC's preemptive authority, and that restores the ability of States to protect their citizens would be a positive step for Congress to take.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Operating Subsidiaries of National Banks

This is a searchable list of many of the national bank operating subsidiaries that do business directly with consumers. **Please Note: National bank operating subsidiaries that offer insurance, securities, investment advisory, or commodities products or services are not included in this list.** Those types of operating subsidiaries are generally subject to the oversight of their special functional regulator such as the state insurance commissioner or securities department. Consumers with complaints regarding such subsidiaries should ask the subsidiary to identify its primary functional regulator and should file their complaints with that agency.

If you are unable to find your company on this list, but still believe that it may be subject to OCC supervision, please contact the CAG for further assistance.

Search Instructions

This list of operating subsidiaries is an Adobe PDF file that has been opened in your browser window. To find a specific company on the list, you can either scroll down the list or use the search tool that is opened by clicking on the search icon (the "binoculars" icon on your tool bar). To do a search using the search tool:

1. On the toolbar, click the search tool icon (the binoculars). A search box will open.

2. Type the entire name of the company or part of the company name that you want to search for.

3. Select any of the following options that will work for your search:

   - *Whole Words Only* finds only occurrences of the complete words or name you enter in the text box. For example, if you know that the name of the company includes the exact word "mortgage", this option will make sure that the word "mortgages" will not be highlighted in search result.
   - *Case-Sensitive* finds only occurrences of the words that are in the case that you typed. So if you know which words are capitalized in the name of your company, this option will help target your search.

4. Click *Find*. You will be taken to the first place in the list where your search words appear. The search words will be highlighted by bold text. By clicking on the icon that looks like a smaller pair of binoculars with an arrow on top (which is to the right of the larger binocular icon), you can advance further down to any other places your words appear.

OPERATING SUBSIDIARY NAME	CITY	STATE	PARENT BANK
1ST CHOICE MORTGAGE, LLC	GREENSBORO	NC	NATIONAL CITY BANK OF INDIANA
1ST FINANCIAL SERVICES OF COLORADO, LLC	LONE TREE	CO	WELLS FARGO BANK, N.A. (See Footnote 1)
1ST PREMIER MORTGAGE, LP	CARSON CITY	NV	NATIONAL CITY BANK OF INDIANA
	A		
ABN AMRO MORTGAGE BROKERAGE GROUP, INC	NEW YORK	NY	STANDARD FEDERAL BANK N.A.
ABN AMRO MORTGAGE GROUP, INC.	ANN ARBOR	MI	STANDARD FEDERAL BANK N.A.
ACADEMY FINANCIAL SERVICES, LLC	KENNESAW	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
ACCESS MORTGAGE CORPORATION	FORT WALTON BEACH	FL	PARISH NATIONAL BANK
ACCESS NATIONAL MORTGAGE CORPORATION	VIENNA	VA	ACCESS NATIONAL BANK
ACCESS NAT'L LEASING CORPORATION	CHANTILLY	VA	ACCESS NATIONAL BANK
ACCUBANC MORTGAGE	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
ACCULEND MORTGAGE, L.P.	ELK GROVE	CA	NATIONAL CITY BANK OF INDIANA
ACCUMORTGAGE	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
ACTION HOME MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
ADVANCE MORTGAGE	VIRGINIA BEACH	VA	WELLS FARGO BANK, N.A. (See Footnote 1)
ADVANTAGE MORTGAGE PARTNERS, LLC	SUWANEE	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
AFFIRMATIVE MORTGAGE, LLC	BOISE	ID	NATIONAL CITY BANK OF INDIANA
ALL AMERICAN FIRST MORTGAGE, LLC	WALDORF	MD	NATIONAL CITY BANK OF INDIANA
ALTEGRA LOAN SERVICES	PITTSBURGH	PA	NATIONAL CITY BANK OF INDIANA
AMERICAN BEST MORTGAGE, LLC	SUFFOLK	VA	NATIONAL CITY BANK OF INDIANA
AMERICAN BUDGET COMPANY	NEW BREMEN	OH	FIRST NATIONAL BANK IN NEW BREMEN
AMERICAN FINANCE COMPANY	FT. WALTON BEACH	FL	FIRST NATIONAL BANK AND TRUST

AMERICAN MORTGAGE, LLC	STREAMWOOD	IL	AMERICAN NATIONAL BANK OF DEKALB
AMERICAN SECURITIES COMPANY	SAN FRANCISCO	CA	WELLS FARGO BANK, N.A.
AMERICORP FIRST, LLC	STRONGSVILLE	OH	NATIONAL CITY BANK OF INDIANA
AMERIMAX MORTGAGE, LLC	MIDLOTHIAN	VA	NATIONAL CITY BANK OF INDIANA
AMERINATIONAL COMMUNITY SERVICES	ALBERT LEA	MN	AMERICANA NATIONAL BANK
AMERINATIONAL REMITTANCE SERVICES	ALBERT LEA	MN	AMERICANA NATIONAL BANK
ANB MORTGAGE CORPORATION	DANVILLE	VA	AMERICAN NB & TRUST COMPANY
ANGELO LEGAL SERVICES, INC.	SAN ANGLEO	TX	CROCKETT NATIONAL BANK
ASHTON WOODS MORTGAGE, LLC	ALPHARETTA	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
ASSOCIATED MORTGAGE, INC.	DE PERE	WI	ASSOCIATED BANK, N.A.
ASSOCIATES AUTO CLUB SERVICES, INC.	IRVING	TX	CITIBANK USA, N.A.
ASSOCIATES CAPITAL SERVICES CORPORATION	IRVING	TX	CITIBANK, N.A.
ASSOCIATES COMMERCIAL LEASING COMPANY, INC.	IRVING	TX	CITIBANK, N.A.
ASSOCIATES/TRANS-NATIONAL LEASING, INC.	IRVING	TX	CITIBANK, N.A.
ASSURED MORTGAGE, LP	TRACY	CA	NATIONAL CITY BANK OF INDIANA
	B		
BANC OF AMERICA AUTO FINANCE CORPORATION	JACKSONVILLE	FL	BANK OF AMERICA, N.A.
BANC ONE ACCEPTANCE CORPORATION	COLUMBUS	OH	BANK ONE, N.A.
BANC ONE AUTOLEASE, LTD.	COLUMBUS	OH	BANK ONE, N.A.
BANC ONE KENTUCKY VEHICLE LEASING COMPANY	LOUISVILLE	KY	BANK ONE, N.A.
BANC ONE REALTY ADVISORS, INC.	TROY	MI	BANK ONE, N.A.
BANCOKLAHOMA MORTGAGE CORPORATION	TULSA	OK	BANK OF OKLAHOMA, N.A.
BANK OF AMERICA TRUST COMPANY OF DELAWARE, N.A.	GREENVILLE	DE	BANK OF AMERICA, N.A.
BANK ONE EXCHANGE CORPORATION	CHICAGO	IL	BANK ONE, N.A.

BAYBANKS CREDIT CORPORATION	BOSTON	MA	FLEET NATIONAL BANK
BAYBANKS MORTGAGE CORPORATION	BOSTON	MA	FLEET NATIONAL BANK
BENEFIT MORTGAGE, LLC	FRANKLIN	OH	WELLS FARGO BANK, N.A. (See Footnote 1)
BOSGRAAF CAPITAL COMPANY, LLC	COLUMBUS	OH	HUNTINGTON NATIONAL BANK
BOSTON SAFE DEPOSIT FINANCE COMPANY, INC.	BOSTON	MA	MELLON TRUST OF NEW ENGLAND, N.A.
BUILDERS CAPITAL MORTGAGE, LLC	MEMPHIS	TN	WELLS FARGO BANK, N.A. (See Footnote 1)
BUILDERS MORTGAGE COMPANY, LLC	FORT MYERS	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
BUILDERS MORTGAGE, L.P.	TEMECULA	CA	NATIONAL CITY BANK OF INDIANA
C			
CAPE HENRY MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
CAPITAL PACIFIC HOME LOANS, LP	NEWPORT BEACH	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
CAPITAL TEMPFUNDS, INC.	CHARLOTTE	NC	UNION PLANTERS BANK, N.A.
CAPITAL WEST MORTGAGE, INC.	GREAT BEND	KS	FARMERS BANK & TRUST, NA
CAPSTONE MORTGAGE FUNDING, L.L.C.	NEW PORT RICHEY	FL	NATIONAL CITY BANK OF INDIANA
CBT REALTY CORPORATION	BOSTON	MA	FLEET NATIONAL BANK
CENTRAL-ATLANTIC LEASING	HAMMONTON	NJ	MINOTOLA NATIONAL BANK
CHARTER LENDING, LLC	WYANDOTTE	MI	CHARTER ONE BANK, N.A.
CHARTER MORTGAGE	HOFFMAN ESTATES	IL	CHARTER NB AND TRUST
CHARTER ONE / WHITTAKER MORTGAGE, LLC	ST. PETERS	MO	CHARTER ONE BANK, N.A.
CHARTER ONE AUTO FINANCE CORPORATION	ROCHESTER	NY	CHARTER ONE BANK, N.A.
CHARTER ONE MORTGAGE CORPORATION	RICHMOND	VA	CHARTER ONE BANK, N.A.
CHARTER ONE MORTGAGE OF DAYTON, LLC	DAYTON	OH	CHARTER ONE BANK, N.A.
CHARTER ONE MORTGAGE OF WILLIAMSBURG, LLC	WILLIAMSBURG	VA	CHARTER ONE BANK, N.A.
CHARTER ONE-PHCC, LLC	CHARLOTTE	NC	CHARTER ONE BANK, N.A.

CHASE BANKCARD SERVICES, INC.	NEWARK	DE	CHASE MANHATTAN BANK USA, N.A.
CHATEAU HOME MORTGAGE, LLC	WESTMINSTER	CO	WELLS FARGO BANK, N.A. (See Footnote 1)
CITIBANK (SOUTH DAKOTA), N.A.	SIOUX FALLS	SD	CITIBANK, N.A.
CITICAPITAL COMMERCIAL CORPORATION	IRVING	TX	CITIBANK, N.A.
CITICAPITAL COMMERCIAL LEASING CORPORATION	IRVING	TX	CITIBANK, N.A.
CITICAPITAL SMALL BUSINESS FINANCE, INC.	IRVING	TX	CITIBANK, N.A.
CITICAPITAL TECHNOLOGY FINANCE, INC.	READING	PA	CITIBANK, N.A.
CITICAPITAL TRAILER RENTAL, INC.	IRVING	TX	CITIBANK, N.A.
CITICORP CREDIT SERVICES, INC.	LONG ISLAND CITY	NY	CITIBANK, N.A.
CITICORP CREDIT SERVICES, INC. (MARYLAND)	HAGERSTOWN	MD	CITIBANK, N.A.
CITICORP CREDIT SERVICES, INC. (USA)	KANSAS CITY	MO	CITIBANK, N.A.
CITICORP DINERS CLUB INC.	CHICAGO	IL	CITIBANK USA, N.A.
CITICORP INVESTOR LEASE, INC.	NEW CASTLE	DE	CITIBANK, N.A.
CITICORP LEASING, INC.	NEW YORK	NY	CITIBANK, N.A.
CITICORP MULTILEASE (SEF), INC.	NEW CASTLE	DE	CITIBANK, N.A.
CITICORP PAYMENT SERVICES, INC.	LONG ISLAND CITY	NY	CITIBANK, N.A.
CITICORP TRUST SOUTH DAKOTA	SIOUX FALLS	SD	CITIBANK USA, N.A.
CITICORP TRUST, N.A.	LOS ANGELES	CA	CITIBANK, N.A.
CITICORP TRUST, N.A. (FLORIDA)	PALM BEACH	FL	CITIBANK, N.A.
CITICORP USA, INC.	NEW YORK	NY	CITIBANK, N.A.
CITICORP VENDOR FINANCE, INC.	MAHWAH	NJ	CITIBANK, N.A.
CITIHOUSING, INC.	SIOUX FALLS	SD	CITIBANK (SOUTH DAKOTA), N.A.
CITIMORTGAGE ASSET MANAGEMENT, INC.	GARDEN CITY	NY	CITIBANK, N.A.
CITITRUST (NEW JERSEY) LIMITED	SHORT HILLS	NJ	CITIBANK, N.A.

CITIZENS CREDIT CORPORATION	STORM LAKE	IA	CITIZENS 1ST NB OF STORM LAKE
CLASSNOTES INC.	SACRAMENTO	CA	WACHOVIA BANK, N.A.
CNB E-LYSIUM SYSTEMS, JV	ENID	OK	CENTRAL NATIONAL BANK AND TRUST COMPANY OF ENID
CNB EQUITY CORPORATION	BOSTON	MA	FLEET NATIONAL BANK
CNC MORTGAGE LLC	PAINTSVILLE	KY	CITIZENS NATIONAL BANK PAINTSVILLE
COLONIAL LOAN ASSOCIATION	MORRISTOWN	TN	UNION PLANTERS BANK, N.A.
COLORADO PROFESSIONALS MORTGAGE, LLC	GOLDEN	CO	WELLS FARGO BANK, N.A. (See Footnote 1)
COMMONWEALTH UNITED MORTGAGE COMPANY	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
COMMUNITY FIRST HOME MORTGAGE, INC.	FARGO	ND	COMMUNITY FIRST NATIONAL BANK
COMMUNITY FIRST MORTGAGE, LLC	DENVER	CO	COMMUNITY FIRST NATIONAL BANK
COMMUNITY RESIDENTIAL MORTGAGE SERVICES, LLC	CHARLOTTE	NC	WELLS FARGO BANK, N.A. (See Footnote 1)
CONGRESS FINANCIAL CORPORATION	WILMINGTON	DE	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (CENTRAL)	CHICAGO	IL	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (FLORIDA)	MIAMI	FL	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (NEW ENGLAND)	BOSTON	MA	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (NORTHWEST)	PORTLAND	OR	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (SOUTHERN)	ATLANTA	GA	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (SOUTHWEST)	DALLAS	TX	WACHOVIA BANK, N.A.
CONGRESS FINANCIAL CORPORATION (WESTERN)	PASADENA	CA	WACHOVIA BANK, N.A.
COPELCO EQUIPMENT LEASING CORPORATION	WILMINGTON	DE	CITIBANK, N.A.
CORNERSTONE MORTGAGE COMPANY	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA
CORNERSTONE MORTGAGE PARTNERS I I, LLC	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA
CORNERSTONE MORTGAGE PARTNERS IV, LLC	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA
CORNERSTONE MORTGAGE PARTNERS V, LLC	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA

CORNERSTONE MORTGAGE PARTNERS VI, LLC	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA
CORNERSTONE MORTGAGE PARTNERS VII, LLC	HOUSTON	TX	FIRST NATIONAL BANK OF OMAHA
COVENANT MORTGAGE, LLC	NEW ALBANY	IN	NATIONAL CITY BANK OF INDIANA
CRAFT MORTGAGE LLC	MONROE	NC	CHARTER ONE BANK, N.A.
D			
DELAWARE TRUST CAPITAL MANAGEMENT, INC.	WILMINGTON	DE	WACHOVIA BANK OF DELAWARE, N.A.
DELMARVA MORTGAGE, LLC	REHOBOTH BEACH	DE	NATIONAL CITY BANK OF INDIANA
DELUCA-REALEN MORTGAGE, LLC	YARDLEY	PA	WELLS FARGO BANK, N.A. (See Footnote 1)
DISTINCTIVE MORTGAGE COMPANY, LLC	COLUMBUS	OH	HUNTINGTON NATIONAL BANK
DOCKSIDE FINANCE COMPANY	FT. PIERCE	FL	RIVERSIDE NATIONAL BANK OF FLORIDA
E			
EAB COMMUNITY DEVELOPMENT CORPORATION	UNIONDALE	NY	CITIBANK, N.A.
EASTERN MORTGAGE COMPANY	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
EDWARD JONES MORTGAGE, LLC	MINNEAPOLIS	MN	WELLS FARGO BANK, N.A. (See Footnote 1)
ENTER MORTGAGE, LLC	PACE	FL	NATIONAL CITY BANK OF INDIANA
ENTERPRISE STAFF SOLUTIONS	MEMPHIS	TN	ENTERPRISE NATIONAL BANK
EQUICREDIT CORPORATION OF AMERICA	JACKSONVILLE	FL	BANK OF AMERICA, N.A.
EQUIPMENT FINANCE, LLC	POWHATAN	PA	BANK OF LANCASTER COUNTY N.A.
EQUITY LENDING, INC.	EDINA	MN	COMMUNITY FIRST NATIONAL BANK
EXECUTIVE HOME MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
EXTRACO MORTGAGE	WACO	TX	EXTRACO BANKS, N.A.
F			
FAMILY HOME MORTGAGE, LLC	TUKWILA	WA	WELLS FARGO BANK, N.A. (See Footnote 1)
FFFC (Inactive)	SAN JOSE	CA	NATIONAL CITY BANK OF INDIANA

FFFC, INC. (Inactive)	SAN JOSE	CA	NATIONAL CITY BANK OF INDIANA
FHEL	IRVING	TX	FIRST TENNESSEE BANK N.A.
FINANCIAL RESOURCES MORTGAGE, LLC	TROY	MI	WELLS FARGO BANK, N.A. (See Footnote 1)
FINANCIAL SERVICES OF ARIZONA, LLC	PHOENIX	AZ	WELLS FARGO BANK, N.A. (See Footnote 1)
FIRST CAPITAL HOME MORTGAGE, LLC	NEWPORT NEWS	VA	NATIONAL CITY BANK OF INDIANA
FIRST CHESAPEAKE MORTGAGE, LLC	CHARLOTTE	NC	CHARTER ONE BANK, N.A.
FIRST COUNTY MORTGAGE	ALEXANDRIA	VA	FIRST TENNESSEE BANK N.A.
FIRST FLIGHT MORTGAGE, LLC	KILL DEVIL HILLS	NC	NATIONAL CITY BANK OF INDIANA
FIRST FOUNDATION MORTGAGE, LLC	FREDERICK	MD	WELLS FARGO BANK, N.A. (See Footnote 1)
FIRST FRANKLIN FINANCIAL CORPORATION	SAN JOSE	CA	NATIONAL CITY BANK OF INDIANA
FIRST FRANKLIN LOAN SERVICES (Services Subprime)	PITTSBURGH	PA	NATIONAL CITY BANK OF INDIANA
FIRST HORIZON HOME LOAN CORPORATION	IRVING	TX	FIRST TENNESSEE BANK N.A.
FIRST INDEPENDENT MORTGAGE, LLC	BURLINGTON	MA	NATIONAL CITY BANK OF INDIANA
FIRST MORTGAGE GROUP, LLC, THE	NEW ORLEANS	LA	NATIONAL CITY BANK OF INDIANA
FIRST MORTGAGE OF FLORIDA, LLC	SARASOTA	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
FIRST NATIONAL ACCEPTANCE COMPANY	EAST LANSING	MI	FIRST NATIONAL BANK OF AMERICA
FIRST NATIONAL CREDIT CORPORATION	OMAHA	NE	FIRST NATIONAL OF NEBRASKA
FIRST NATIONAL EQUIPMENT FINANCING, INC.	OMAHA	NE	FIRST NATIONAL OF OMAHA
FIRST OF AMERICA MORTGAGE COMPANY	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
FIRST PATRIOT MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
FIRST UNION TRUST COMPANY OF CALIFORNIA	PHILADELPHIA	PA	WACHOVIA BANK, N.A.
FIRSTMERIT LEASING COMPANY	AKRON	OH	FIRSTMERIT BANK, N.A.
FIRSTMERIT MORTGAGE CORPORATION	CANTON	OH	FIRSTMERIT BANK, N.A.
FLEET (DELAWARE) CONSUMER SERVICES, INC.	WILMINGTON	DE	FLEET NATIONAL BANK

FLEET (NJ) CREDIT CORPORATION	BOSTON	MA	FLEET NATIONAL BANK
FLEET CREDIT CARD SERVICES LP	PROVIDENCE	RI	FLEET NATIONAL BANK
FLEET FINANCIAL PENNSYLVANIA CORPORATION	PORTLAND	ME	FLEET NATIONAL BANK
FLEETMARK, INC.	IRVING	TX	CITIBANK, N.A.
FLEETWOOD FINANCIAL LLC	FLEETWOOD	PA	FIRST NATIONAL BANK IN FLEETWOOD
FNAC OF NORTH AMERICA	EAST LANSING	MI	FIRST NATIONAL BANK OF AMERICA
FNMC	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
FORUM SHAREHOLDER SERVICES, LIMITED LIABILITY COMPANY	PORTLAND	ME	CITIBANK, N.A.
FOUNDATION MORTGAGE SERVICES, LLC	MASON	OH	WELLS FARGO BANK, N.A. (See Footnote 1)
FREEDOM FINANCIAL ADVISORS, LP	ROSEVILLE	CA	NATIONAL CITY BANK OF INDIANA
FREEDOM FIRST MORTGAGE, LLC	BATON ROUGE	LA	NATIONAL CITY BANK OF INDIANA
FT MORTGAGE HOLDING CORPORATION	IRVING	TX	FIRST TENNESSEE BANK N.A.
FT REAL ESTATE INFORMATION MORTGAGE SOLUTIONS, INC.	WILMINGTON	DE	FIRST TENNESSEE BANK N.A.
FTN FINANCIAL CAPITAL ASSETS CORPORATION	MEMPHIS	TN	FIRST TENNESSEE BANK N.A.
FULTON FINANCIAL ADVISORS	LANCASTER	PA	FULTON FINANCIAL CORPORATION
	G		
GATEWAY FIRST MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
GOLD COAST HOME MORTGAGE	SAN DIEGO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
GREENRIDGE MORTGAGE SERVICES, LLC	GRAND RAPIDS	MI	WELLS FARGO BANK, N.A. (See Footnote 1)
GUARANTEE PACIFIC MORTGAGE, LLC	MODESTO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
	H		
HALLMARK MORTGAGE GROUP, LLC	GILBERTSVILLE	PA	WELLS FARGO BANK, N.A. (See Footnote 1)
HEARTLAND SECURITY MORTGAGE, LLC	FAIRFIELD	OH	NATIONAL CITY BANK OF INDIANA
HENDRICKS MORTGAGE, LLC	HARLEYSVILLE	PA	WELLS FARGO BANK, N.A. (See Footnote 1)

HERITAGE HOME MORTGAGE, LLC	HERSHEY	PA	NATIONAL CITY BANK OF INDIANA
HOME CENTRAL MORTGAGE, LLC	BEL AIR	MD	NATIONAL CITY BANK OF INDIANA
HOME FINANCING, LLC	COLLEGEVILLE	PA	NATIONAL CITY BANK OF INDIANA
HOME LOAN EXPRESS, LLC	NORTH BARRINGTON	IL	WELLS FARGO BANK, N.A. (See Footnote 1)
HOME MORTGAGE CENTRE, LLC	OLNEY	MD	NATIONAL CITY BANK OF INDIANA
HOME MORTGAGE EXCHANGE, LLC	BUFFALO GROVE	IL	WELLS FARGO BANK, N.A. (See Footnote 1)
HOMELAND FIRST MORTGAGE, LLC	DOVER	DE	NATIONAL CITY BANK OF INDIANA
HOMELAND MORTGAGE, LLC	CLEARWATER	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
HOMEOWNERS LOAN CORPORATION	ATLANTA	GA	THE LAREDO NATIONAL BANK
HOMEPRIDE MORTGAGE, LP	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
HOMEQ SERVICING CORPORATION (Services Subprime)	NORTH HIGHLANDS	CA	WACHOVIA BANK, N.A.
HOMESERVICES LENDING, LLC	EDINA	MN	WELLS FARGO BANK, N.A. (See Footnote 1)
HOMESOURCE MORTGAGE SERVICES, LLC	BETHLEHEM	PA	NATIONAL CITY BANK OF INDIANA
HOMESYNC FINANCIAL SERVICES, LLC	MILBURN	NJ	NATIONAL CITY BANK OF INDIANA
HOMETOWN MORTAGE, LLC	ALLENTOWN	PA	NATIONAL CITY BANK OF INDIANA
HORIZON TRUST & INVESTMENT	MICHIGAN CITY	IL	HORIZON BANK, NA
HUNTINGTON/NAC HOLDINGS, INC.	COLUMBUS	OH	HUNTINGTON NATIONAL BANK
HUNTINGTON/NAC MORTGAGE CAPITAL, LLC	COLUMBUS	OH	HUNTINGTON NATIONAL BANK
I			
INTERCOASTAL MORTGAGE, LLC	MAYOCK	NC	NATIONAL CITY BANK OF INDIANA
J			
JEFFERSON CITY MORTGAGE COMPANY, LLC	JEFFERSON CITY	MO	EXCHANGE NATIONAL BANK OF JEFFERSON CITY
JEFFERSON HERITAGE MORTGAGE COMPANY	MANCHESTER	MO	UNION PLANTERS BANK, N.A.
JTS FINANCIAL, LLC	SACRAMENTO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)

K			
KEY MERCHANT SERVICES, LLC	ATLANTA	GA	KEY BANK USA, N.A.
L			
LEADER MORTGAGE COMPANY, LLC	CLEVELAND	OH	U.S. BANK N.A.
LEADER MORTGAGE, LLC	BRENTWOOD	TN	WELLS FARGO BANK, N.A. (See Footnote 1)
LEADING EDGE MORTGAGE, LLC	ALEXANDRIA	VA	NATIONAL CITY BANK OF INDIANA
LIBERTY WEST MORTGAGE, LP	SAN DIEGO	CA	NATIONAL CITY BANK OF INDIANA
LINEAR FINANCIAL, LP	SAN DIEGO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
LOWER BUCKS MORTGAGE, LLC	FAIRLESS HILLS	PA	NATIONAL CITY BANK OF INDIANA
M			
MAIN STREET MORTGAGE	RICHMOND	VA	BANK OF POWHATAN, N.A.
MAINE CREDIT HOLDINGS, INC.	COLUMBIA	SC	FLEET NATIONAL BANK
MC OF AMERICA, LLC	FT WAYNE	IN	WELLS FARGO BANK, N.A. (See Footnote 1)
MERCANTILE MORTGAGE, LLC	BALTIMORE	MD	WELLS FARGO BANK, N.A. (See Footnote 1)
MERCHANTS CAPITAL RESOURCES	BLOOMINGTON	MN	MERCHANTS BANK, N.A.
MERCHANTS NEW YORK COMMERCIAL CORPORATION.	NEW YORK	NY	VALLEY NATIONAL BANK
MERIDIAN HOME MORTGAGE, LP	ONTARIO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
METROPOLITAN MORTGAGE, LLC	ALEXANDRIA	VA	NATIONAL CITY BANK OF INDIANA
MICHIGAN HOME MORTGAGE, LLC	GRAND BLANC	MI	WELLS FARGO BANK, N.A. (See Footnote 1)
MID ATLANTIC MORTGAGE, LLC	KITTY HAWK	NC	NATIONAL CITY BANK OF INDIANA
MIDAMERICA NATIONAL TRAVEL	CANTON	IL	MIDAMERICA NATIONAL BANK
MILLENNIUM CAPITAL, INC	RESTON	VA	MILLENNIUM BANK, N.A.
MILLENNIUM SUNBELT MORTGAGE	LAS VEGAS	NV	MILLENNIUM BANK, N.A.
MILLENNIUM WHOLESALE LENDING	RESTON	VA	MILLENNIUM BANK, N.A.

MILLSTONE MORTGAGE, LLC	BETHLEHEM	PA	NATIONAL CITY BANK OF INDIANA
MISSOURI CAPITAL FINANCE	CARTHAGE	MO	HOMETOWN BANCSHARES
MITCHELL MORGAGE COMPANY, LLC	THE WOODLANDS	TX	SOUTHWEST BANK OF TEXAS, N.A.
MJC MORTGAGE COMPANY, LLC	MACOMB	MI	WELLS FARGO BANK, N.A. (See Footnote 1)
MOBILE CONSULTANTS, INC.	ALLIANCE	OH	FIRSTMERIT BANK, N.A.
MORRISON FINANCIAL SERVICES, LLC	MARIETTA	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
MORTGAGE 100, LLC	LAKEWOOD	CO	WELLS FARGO BANK, N.A. (See Footnote 1)
MORTGAGE CONSTRUCTION FINANCE, LLC	FAIRFAX	VA	NATIONAL CITY BANK OF INDIANA
MORTGAGE EXPRESS CORPORATION	VERSAILLES	KY	CITIZENS COMMERCE NATIONAL BANK
MORTGAGE ONE	FT. WALTON BEACH	FL	FIRST NATIONAL BANK AND TRUST
MORTGAGE ONE, LP	MURRIETA	CA	NATIONAL CITY BANK OF INDIANA
MORTGAGE PROFESSIONALS OF TAMPA BAY, LLC	TAMPA	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
MORTGAGE PROS, LLC	ROCKVILLE	MD	NATIONAL CITY BANK OF INDIANA
MORTGAGES ON-SITE, LLC	ATLANTA	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
MORTGAGES UNLIMITED, LLC	HILTON HEAD ISLAND	SC	WELLS FARGO BANK, N.A. (See Footnote 1)
MPNB, INC.	MT. PROSPECT	IL	MOUNT PROSPECT NATIONAL BANK
MUTUAL SERVICE MORTGAGE, LLC	GREENWOOD VILLAGE	CO	WELLS FARGO BANK, N.A. (See Footnote 1)
N			
NAPERVILLE MORTGAGE, LLC	NAPERVILLE	IL	WELLS FARGO BANK, N.A. (See Footnote 1)
NAT PENN LEASING	BOYERTOWN	PA	NATIONAL PENN BANK
NATIONAL AMERICAN MORTGAGE, LLC	LAKE HAVASU CITY	AZ	NATIONAL CITY BANK OF INDIANA
NATIONAL CITY CARD SERVICES	KALAMAZOO	MI	NATIONAL CITY BANK
NATIONAL CITY COMMERCIAL FINANCE, INC.	CLEVELAND	OH	NATIONAL CITY BANK
NATIONAL CITY HOME LOAN SERVICES, INC. (Services Subprime)	PITTSBURGH	PA	NATIONAL CITY BANK OF INDIANA

NATIONAL CITY INDIANA, LLC	INDIANAPOLIS	IN	NATIONAL CITY BANK OF INDIANA
NATIONAL CITY LEASING CORPORATION	LOUISVILLE	KY	NATIONAL CITY BANK OF KENTUCKY
NATIONAL CITY LOAN SERVICES	PITTSBURGH	PA	NATIONAL CITY BANK OF INDIANA
NATIONAL CITY MORTGAGE COMPANY	MIAMISBURG	OH	NATIONAL CITY BANK OF INDIANA
NATIONAL CITY MORTGAGE SERVICES COMPANY	KALAMAZOO	MI	NATIONAL CITY BANK OF MICHIGAN/ILLINOIS
NATIONAL CITY OHIO, LLC	INDIANAPOLIS	IN	NATIONAL CITY BANK
NATIONAL HOME EQUITY	CLEVELAND	OH	NATIONAL CITY BANK
NATIONAL IRON MORTGAGE COMPANY	SALISBURY	CT	NATIONAL IRON BANK
NATIONAL MORTGAGE, LLC	URBANDALE	IA	WELLS FARGO BANK, N.A. (See Footnote 1)
NATIONSCREDIT FINANCIAL SERVICES CORPORATION (Stopped Subprime 8/01)	IRVING	TX	BANK OF AMERICA, N.A.
NEMAC, INC.	WATERBURY	CT	FLEET NATIONAL BANK
NORTHLAND ESCROW SERVICES, INC.	ANCHORAGE	AK	WELLS FARGO BANK ALASKA, N.A.
NORWEST AUTO FINANCE, INC.	MINNEAPOLIS	MN	WELLS FARGO BANK MINNESOTA, N.A.
P			
PCM MORTGAGE, LLC	WHEATON	IL	WELLS FARGO BANK, N.A. (See Footnote 1)
PENINSULA MORTGAGE, LLC	NEWPORT NEWS	VA	NATIONAL CITY BANK OF INDIANA
PEOPLES LOAN SERVICES, INC.	WILMINGTON	DE	PEOPLES BANK, N.A.
PEOPLES MORTGAGE CORPORATION	COLORADO SPRINGS	CO	PEOPLES NATIONAL BANK
PEOPLES NATIONAL TITLE	COLORADO SPRINGS	CO	PEOPLES NATIONAL BANK
PINEHURST MORTGAGE, LLC	PINEHURST	NC	NATIONAL CITY BANK OF INDIANA
PINNACLE MORTGAGE OF NEVADA, LLC	RENO	NV	WELLS FARGO BANK, N.A. (See Footnote 1)
PLATINUM FIRST MORTGAGE, LP	RENO	NV	NATIONAL CITY BANK OF INDIANA
PREFERRED CAPITAL MORTGAGE	LANCASTER	PA	AMERICAN HOME BANK, N.A.
PREMIER HOME MORTGAGE	SAN MARINO	CA	WELLS FARGO BANK, N.A. (See Footnote 1)

PREMIER LENDING SERVICES LP	ROSEVILLE	CA	NATIONAL CITY BANK OF INDIANA
PREMIER MORTGAGE OF FLORIDA, LLC	TAMPA	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
PREMIUM LEASE & FINANCE, LLC	IRVING	TX	CITIBANK, N.A.
PRIORITY MORTGAGE, LLC	PALM BEACH GARDEN	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
PROFESSIONAL FINANCIAL SERVICES OF ARIZONA, LLC	GLENDALE	AZ	WELLS FARGO BANK, N.A. (See Footnote 1)
PROGRESS INVESTMENT MANAGEMENT COMPANY	SAN FRANCISCO	CA	FLEET NATIONAL BANK
PROVIDENCE GROUP ADVISORS, INC.	PROVIDENCE	RI	FLEET NATIONAL BANK
PROVIDENT MORTGAGE COMPANY, LLC	TUCKER	GA	WELLS FARGO BANK, N.A. (See Footnote 1)
PV NATIONAL MORTGAGE COMPANY	SCOTTSBLUFF	NE	PLATTE VALLEY NATIONAL BANK
Q			
QUEST HOME LOANS LLC	MARTINSBURG	WV	NATIONAL CITY BANK OF INDIANA
R			
REAL LIVING MORTGAGE, LLC	COLUMBUS	OH	WELLS FARGO BANK, N.A. (See Footnote 1)
REGIONAL FIRST MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
RELIABLE MORTGAGE INVESTORS, LLC	GREENBELT	MD	NATIONAL CITY BANK OF INDIANA
REO MORTGAGE SERVICES, LLC	BOYERTOWN	PA	NATIONAL CITY BANK OF INDIANA
RESELLER FINANCE CORPORATION	WEST CHESTER	PA	CITIBANK, N.A.
RESORT TRUST MORTGAGE, LLC	DESTIN	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
RIGGS BANK & TRUST COMPANY (BAHAMAS) LIMITED	NASSAU	BAHAMAS	RIGGS BANK N.A.
RIGGS REAL ESTATE INVESTMENT CORPORATION	MCLEAN	VA	RIGGS BANK N.A.
RIGHT HOME MORTGAGE INC	HOUSTON	TX	NATIONAL CITY BANK OF INDIANA
RODDEL MORTGAGE COMPANY, LP	CORONA	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
RREIC HOLDINGS INC.	MCLEAN	VA	RIGGS BANK N.A.

S			
SECOLINK SETTLEMENT SERVICES	AMHERST	NY	KEY BANK USA, N.A.
SECURITY FIRST FINANCIAL GROUP	ORMONDE BEACH	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
SIGNATURE HOME MORTGAGE, LP	VISALIA	CA	WELLS FARGO BANK, N.A. (See Footnote 1)
SM LENDING	DENVER	CO	FIRST NATIONAL BANK OF OMAHA
SOUTHEAST HOME MORTGAGE, LLC	KNOXVILLE	TN	WELLS FARGO BANK, N.A. (See Footnote 1)
SOUTHERN COURIER SERVICES	FT. WALTON BEACH	FL	FIRST NATIONAL BANK AND TRUST
SOUTHERN ILLINOIS TITLE INSURANCE SERVICES, INC.	CARMI	IL	FIRST NATIONAL BANK OF CARMI
SOUTHERN OHIO MORTGAGE, LLC	DAYTON	OH	WELLS FARGO BANK, N.A. (See Footnote 1)
SPH MORTGAGE	SCOTTSDALE	AZ	WELLS FARGO BANK, N.A. (See Footnote 1)
STERLING BANK LEASING	NEW YORK	NY	STERLING NATIONAL BANK
STERLING NATIONAL MORTGAGE COMPANY	GREAT NECK	NY	STERLING NATIONAL BANK
STERLING NATIONAL MORTGAGE COMPANY	RICHMOND	VA	STERLING NATIONAL BANK
STOCK FINANCIAL SERVICES, LLC	RALEIGH	NC	WELLS FARGO BANK, N.A. (See Footnote 1)
STUDENT LOAN CORPORATION	PITTSFORD	NY	CITIBANK, N.A.
SUMMIT FINANCIAL LLC	HERNDON	VA	SHENANDOAH VALLEY NATIONAL BANK
SUMMIT FINANCIAL SERVICES GROUP, LP	BETHLEHEM	PA	FLEET NATIONAL BANK
SUMMIT PARTICIPATION CORPORATION	HARTFORD	CT	FLEET NATIONAL BANK
SUNDANCE MORTGAGE, LLC	ALBUQUERQUE	NM	WELLS FARGO BANK, N.A. (See Footnote 1)
SUPREME CAPITAL MORTGAGE, LLC	TUCSON	AZ	NATIONAL CITY BANK OF INDIANA
T			
TCF MORTGAGE CORPORATION	MINNEAPOLIS	MN	TCF NATIONAL BANK
TIDEWATER FIRST MORTGAGE, LLC	NORFOLK	VA	NATIONAL CITY BANK OF INDIANA
TITLE FIRST OF NEBRASKA, LLC	OMAHA	NE	FIRST NATIONAL BANK OF OMAHA

TOTAL MORTGAGE SOLUTIONS	IRVING	TX	FIRST TENNESSEE BANK N.A.
TOWER MORTGAGE, LLC	CHESAPEAKE	VA	NATIONAL CITY BANK OF INDIANA
TOWN & COUNTRY LEASING, LLC	EAST PETERSBURG	PA	BANK OF LANCASTER COUNTY, N.A.
TOWN AND COUNTRY LENDING, LLC	ROYERSFORD	PA	NATIONAL CITY BANK OF INDIANA
TOWN SQUARE MORTGAGE, LLC	COLLIERVILLE	TN	NATIONAL CITY BANK OF INDIANA
TRG FINANCIAL, LLC	MIAMI	FL	WELLS FARGO BANK, N.A. (See Footnote 1)
TRICOM MORTGAGE, LLC	MINNEAPOLIS	MN	WELLS FARGO BANK, N.A. (See Footnote 1)
U			
U. S. BANCORP CONSUMER LEASING, INC.	FARGO	ND	U.S. BANK N.A.
U.P. COURIERS	NORWAY	MI	FIRST NATIONAL BANK OF NORWAY
U.S. BANCORP CONSUMER FINANCE OF KENTUCKY, INC.	PADUCAH	KY	U.S. BANK N.A.
U.S. BANCORP NATIONAL ACCOUNT SERVICES, LLC	CINCINNATI	OH	U.S. BANK N.A.
ULTIMATE HOME LOANS, LP	CORONA	CA	NATIONAL CITY BANK OF INDIANA
ULTRON, INC.	LITTLETON	CO	U.S. BANK N.A.
UMB BANC LEASING CORPORATION	KANSAS CITY	MO	UMB BANK, N.A.
UMB CAPITAL CORPORATION	KANSAS CITY	MO	UMB BANK, N.A.
UMB SOUTH DAKOTA TRUST COMPANY	SIOUX FALLS	SD	UMB BANK, N.A.
UNION PLANTERS MORTGAGE, INC	HATTIESBURG	MS	UNION PLANTERS BANK, N.A.
UNITED MICHIGAN MORTGAGE, LLC	BRIGHTON	MI	WELLS FARGO BANK, N.A. (See Footnote 1)
UNITED STATES AUTO CLUB MOTORING DIVISION, INC.	IRVING	TX	CITIBANK USA, N.A.
UNITED STATES FLEET LEASING, INC.	IRVING	TX	CITIBANK, N.A.
UNIVERSAL MASTER SERVICING, LLC	CHARLOTTE	NC	WACHOVIA BANK, N.A.
UNIVERSAL MORTGAGE SERVICES, LLC	NASHVILLE	TN	FIRST TENNESSEE BANK N.A.

V			
VALLEY COMMERCIAL CAPITAL, LLC	WAYNE	NJ	VALLEY NATIONAL BANK
VALLEY MORTGAGE SERVICES, LLC	BETHLEHEM	PA	NATIONAL CITY BANK OF INDIANA
VIRGINIA FIRST MORTGAGE, LLC	GLEN ALLEN	VA	NATIONAL CITY BANK OF INDIANA
VIRGINIA HOME MORTGAGE, LLC	VIRGINIA BEACH	VA	NATIONAL CITY BANK OF INDIANA
VIRGINIA REAL ESTATE MORTGAGE SERVICES, LLC	MANASSAS	VA	FIRST TENNESSEE BANK N.A.
VISTA MORTGAGE, LLC	ZEPHYR COVE	NV	WELLS FARGO BANK, N.A. (See Footnote 1)
VNB LOAN SERVICES, INC.	CHESTNUT RIDGE	NY	VALLEY NATIONAL BANK
VNB MORTGAGE SERVICES, INC.	WAYNE	NJ	VALLEY NATIONAL BANK
W			
WACHOVIA COMMERCIAL MORTGAGE, INC.	ROSEVILLE	CA	WACHOVIA BANK, N.A.
WACHOVIA EXCHANGE SERVICES, LLC	CHARLOTTE	NC	WACHOVIA BANK, N.A.
WACHOVIA MORTGAGE CORPORATION	CHARLOTTE	NC	WACHOVIA BANK, N.A.
WACHOVIA MULTIFAMILY CAPITAL, INC.	BETHESDA	MD	WACHOVIA BANK, N.A.
WACHOVIA SBA LENDING, INC.	ROSEVILLE	CA	WACHOVIA BANK, N.A.
WACHOVIA TRUST COMPANY, N.A.	WILMINGTON	DE	WACHOVIA BANK, N.A.
WASCO FUNDING CORPORATION	NEW YORK	NY	CITIBANK, N.A.
WATCHGUARD REGISTRATION SERVICES, INC.	IRVING	TX	CITIBANK USA, N.A.
WELLS FARGO LEASING CORPORATION (DBA WELLS FARGO AUTO FINANCE, INC)	CONCORD	CA	WELLS FARGO BANK, N.A.
WESTERN NATIONAL TRUST COMPANY	LOS ANGELES	CA	ZIONS FIRST NATIONAL BANK
Y			
YILITE MORTGAGE, LLC	CHARLOTTE	NC	CHARTER ONE BANK, N.A.
YNB CAPITAL DEVELOPMENT, INC	HAMILTON TOWNSHIP	NJ	YARDVILLE NATIONAL BANK

Footnote

1. These operating subsidiaries accept subprime mortgage applications from borrowers. Until May 8, 2004, these operating subsidiaries would refer such applications to Wells Fargo Home Mortgage, Inc. (WFHM). On May 8, 2004, WFHM was merged into its parent bank, Wells Fargo Bank, N.A. The identified operating subsidiaries now refer subprime mortgage applications to Wells Fargo Bank or a third parrty. Thus, there are currently no Wells Fargo operating subsidiaries engaged in subprime mortgage lending.

Wildcard Authority & Parity Statutes – Part I

	Grants State-Chartered Banks Competitive Equality with National Banks	Statute or Regulatory Citation	Automatic Trigger by OCC or Court, or Supervisor's Authorization Required	Grants State-Chartered Banks Competitive Equality with Federal Thrifts	Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Alabama	Yes	5-5A-18	Supervisor's Authorization Required	Yes	5-5A-18.1	Supervisor's Authorization Required
Alaska	Yes	AS 06.01.020 (a)	Supervisor's Authorization Required	Yes	06.01.020 (a)	Supervisor's Authorization Required
Arizona	Yes	ARS 6-184 (A)(2)	Automatic	Yes	ARS 6-184(A)(6)	Automatic
Arkansas	Yes	23-47-101 (c)	Supervisor's Authorization Required	No	N/A	N/A
California	Yes	Financial Code Section 753	Supervisor's Authorization Required	Yes	Financial Code Section 8054	Supervisor's Authorization Required
Colorado	Yes	11-2-103(5)	Supervisor's Authorization Required	No	N/A	N/A
Connecticut	Yes	36a-250(a)(41) of CGS	Automatic[1]	Yes	36a-250(a)(41) of CGS	Automatic[1]
Delaware	Yes	Regulation #5.761.0017 1A	Supervisor's Authorization Required	No	N/A	N/A
DC	Yes	DC Official Code §26-1401.08(a)	Supervisor's Authorization Required	Yes	DC Official Code §26-1401.08(a)	Supervisor's Authorization Required
Florida	Yes	Section 655.061, F.S.	Supervisor's Authorization Required	No	N/A	N/A
Georgia	Yes	OCGA Section 7-1-61	Supervisor's Authorization Required	Yes	OCGA Section 7-1-61	Supervisor's Authorization Required
Hawaii	Yes	Section 412:5-201	Supervisor's Authorization Required	No	N/A	N/A
Idaho	Yes	26-1101(3)	Supervisor's Authorization Required	Yes	26-1101(3)	Supervisor's Authorization Required
Illinois	Yes	205 ILCS 5/5(11)	Automatic	Yes	205 ILCS 5/5(25)	Automatic
Indiana	Yes	28-1-11-3.2	Supervisor's Authorization Required	No	N/A	N/A
Iowa	No	N/A	N/A	No	N/A	N/A
Kansas	Yes	KSA 9-1715	Supervisor's Authorization Required	Yes	KSA 9-1715	Supervisor's Authorization Required
Kentucky	Yes	KRS 287.020 and 287.102	Automatic for 1 and 2 rated banks	Yes	KRS 287.102	Automatic for 1 and 2 rated banks
Louisiana	Yes	LSA-R.S. 6:242(C)	Supervisor's Authorization Required	No	N/A	N/A
Maine	Yes	Title 9-B §416	Automatic	Yes	Title 9-B §416	Automatic
Maryland	Yes	FI §5-504 Md. Code Ann.	Supervisor's Authorization Required	No	N/A	N/A
Massachusetts	Yes	G.L. c. 167F, s. 2, p. 31	Supervisor's Authorization Required	No	N/A	N/A

Wildcard Authority & Parity Statutes – Part I

	Grants State-Chartered Banks Competitive Equality with National Banks	Statute or Regulatory Citation	Automatic Trigger by OCC or Court, or Supervisor's Authorization Required	Grants State-Chartered Banks Competitive Equality with Federal Thrifts	Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Michigan	Yes	MCL 487.12204; MCL 487.14101(2)(b)	Supervisor's Authorization Required	Yes	MCL 487.12204; MCL 487.14101(2)(b)	Supervisor's Authorization Required
Minnesota	Yes	Minn Statute 48.61	Supervisor's Authorization Required	Yes	Minn Statute 48.61	Supervisor's Authorization Required
Mississippi	Yes	81-5-1	Supervisor's Authorization Required	No	N/A	N/A
Missouri	Yes	362.105 – 362.106	Supervisor's Authorization Required	Yes	362.105	Supervisor's Authorization Required
Montana	Yes	32-1-362, MCA	Supervisor's Authorization Required	No	N/A	N/A
Nebraska	Yes	8-1, 140	Automatic	No	N/A	N/A
Nevada	Yes	NRS 662.015	Automatic	Yes	NRS 677.795	Automatic
New Jersey	Yes	NJSA 17:9A-24b.1	Automatic	Yes	NJSA 17:9A-24b.1	Supervisor's Authorization Required
New Mexico	Yes	58-1-54 NMSA 1978	Supervisor's Authorization Required	Yes	58-1-54 NMSA 1978	Supervisor's Authorization Required
New York	Yes	B.L. 14-g and 14-h	Supervisor's Authorization Required	No	N/A	N/A
North Carolina	Yes – S&L No – Comm. Banks	GS 54C-121(b) for loans	Automatic	No	N/A	N/A
North Dakota	Yes	NDCC 6-03-38	Supervisor's Authorization Required	No	N/A	N/A
Ohio	Yes	1121.05 (A)	Supervisor's Authorization Required	Yes	1121.05	Supervisor's Authorization Required
Oklahoma	Yes	6 O.S. §402	Automatic	No	N/A	N/A
Oregon	Yes	ORS 706.795 & 708A.010	Supervisor's Authorization Required	Yes	ORS 706.795	Supervisor's Authorization Required
Pennsylvania	Yes	7 P.S. §201(c)	Supervisor's Authorization Required	Yes	7 P.S. §201(c) [2]	Supervisor's Authorization Required
Puerto Rico	Yes	PR Banking Law	Supervisor's Authorization Required	No	N/A	N/A
Rhode Island	Yes	RIGL §19-3-1(7)	Automatic	Yes	RIGL §19-3-1(7)	Automatic
South Dakota	Yes	51A-2-14.1	Supervisor's Authorization Required	No	N/A	N/A
Tennessee	Yes	T.C.A. §45-2-601	Automatic	Yes	T.C.A. §45-14-105(6)	Supervisor's Authorization Required
Texas	Yes	TFC §32.009	Supervisor's Authorization Required	Yes	TFC §32.010	Supervisor's Authorization Required
Utah	Yes	UCA 7-1-301(3)(a) & 7-3-10	Supervisor's Authorization Required	No	N/A	N/A

Wildcard Authority & Parity Statutes – Part I

	Grants State-Chartered Banks Competitive Equality with National Banks	Statute or Regulatory Citation	Automatic Trigger by OCC or Court, or Supervisor's Authorization Required	Grants State-Chartered Banks Competitive Equality with Federal Thrifts	Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Vermont	Yes	8 V.S.A. §14102	Supervisor's Authorization Required	No	N/A	N/A
Virginia	Yes	§§6.1-5.1 & 6.1-58.1	Supervisor's Authorization Required	No	N/A	N/A
Washington	Yes	RCW 30.04.215(3)	Supervisor's Authorization Required	Yes	RCW 32.08.140(16), RCW 32.08.146	Supervisor's Authorization Required
West Virginia	Yes	§31A-8C-2(a) and §31A-3-2(a)(5)(B)	Supervisor's Authorization Required	Yes	§31A-8C-2(a)	Supervisor's Authorization Required
Wisconsin	Yes	s. 221.0322/DFI-Bkg 3 & 4	Supervisor's Authorization Required	Yes	s. 221.0322	Supervisor's Authorization Required
Wyoming	Yes	W.S. 13-2-101(a)(xiii)	Supervisor's Authorization Required	Yes	W.S. 13-2-101(a)(xiii)	Supervisor's Authorization Required
	Yes 48 / No 2			Yes 28 / No 22		

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Guam, New Hampshire, South Carolina, and Virgin Islands.
[1] Requires prior written notice to Banking Commissioner who has authority to disapprove the activity no later than 30-days after the notice was filed with the Department of Banking.
[2] Pennsylvania thrifts have parity with federal thrifts. 7 P. S. 6020 – 11(a)(22).

Wildcard Authority & Parity Statutes – Part II

	Grants State-Chartered Banks Competitive Equality with Out-of-State, State-Chartered Banks Operating in –State?	Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Alabama	No	N/A	N/A
Alaska	No	N/A	N/A
Arizona	Yes	ARS 6-184 (A)(6)	Automatic
Arkansas	No	N/A	N/A
California	No	N/A	N/A
Colorado	No	N/A	N/A
Connecticut	No	N/A	N/A
Delaware	No	N/A	N/A
DC	Yes	DC Official Code §26-1401.08(a)	Supervisor's Authorization Required
Florida	No	N/A	N/A
Georgia	Yes	OCGA Section 7-1-61	Supervisor's Authorization Required
Hawaii	No	N/A	N/A
Idaho	Yes	26-1101(3)	Supervisor's Authorization Required
Illinois	Yes	205 ILCS 5/5(25)	Automatic
Indiana	No	N/A	N/A
Iowa	No	N/A	N/A
Kansas	Yes	KSA 9-1715	Supervisor's Authorization Required
Kentucky	Yes	KRS 287.102	Automatic for 1 and 2 rated banks
Louisiana	No	N/A	N/A
Maine	No	N/A	N/A
Maryland	No	N/A	N/A
Massachusetts	No	N/A	N/A

Wildcard Authority & Parity Statutes – Part II

	Grants State-Chartered Banks Competitive Equality with Out-of-State, State-Chartered Banks Operating in –State?	Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Michigan	Yes	MCL 487.12204; MCL 487.14101(2)(b)	Supervisor's Authorization Required
Minnesota	No	N/A	N/A
Mississippi	No	N/A	N/A
Missouri	No	N/A	N/A
Montana	No	N/A	N/A
Nebraska	No	N/A	N/A
Nevada	Yes	NRS 662.015	Automatic
New Jersey	Yes	NJSA 17:9A-24b.1	Supervisor's Authorization Required
New Mexico	Yes	58-1-54 NMSA 1978	Supervisor's Authorization Required
New York	No	N/A	N/A
North Carolina	No	N/A	N/A
North Dakota	No	N/A	N/A
Ohio	Yes	1121.05	Supervisor's Authorization Required
Oklahoma	No	N/A	N/A
Oregon	Yes	ORS 706.795	Supervisor's Authorization Required
Pennsylvania	Yes	7 P.A. §201(c), to the extent the activity has been approved by the FDIC under 12 USC §1831a	Supervisor's Authorization Required
Puerto Rico	No	N/A	N/A
Rhode Island	No	N/A	N/A
South Dakota	Yes	51A-2-14 and 14.1	Supervisor's Authorization Required
Tennessee	Yes	T.C.A. §45-2-607(d)	Supervisor's Authorization Required
Texas	Yes	TFC §32.010	Supervisor's Authorization Required
Utah	Yes	UCA 7-1-301(3)(b)	Supervisor's Authorization Required

Wildcard Authority & Parity Statutes – Part II

	Grants State-Chartered Banks Competitive Equality with Out-of-State, State-Chartered Banks Operating in –State?		Statute or Regulatory Citation	Automatic Trigger by OTS or Courts, or Supervisor's Authorization Required
Vermont	No		N/A	N/A
Virginia	Yes		§6.1-58.1	Supervisor's Authorization Required
Washington	Yes		RCW 30.38.080(4); RCW 30.08.140(16); RCW 32.08.140(15)	Supervisor's Authorization Required
West Virginia	Yes		§31A-8D-6	Supervisor's Authorization Required
Wisconsin	Yes		s. 221.0322	Supervisor's Authorization Required
Wyoming	Yes		W.S. 13-2-101(a)(xiii)	Supervisor's Authorization Required
	Yes	**No**		
	23	27		

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Guam, New Hampshire, South Carolina and Virgin Islands.

Wildcard Authority & Parity Statutes – Part III

	Grants State-Chartered Banks Competitive Equality with Any Financial Services Provider	Statute/Citation	Automatic Trigger by OCC or Court, or Supervisor's Determination Required	Restrictions on State's Wildcard Authority
Alabama	No	N/A	N/A	None
Alaska	No	N/A	N/A	Must serve the public convenience and advantage; equalize and maintain the quality of competition between state and federal financial institutions.
Arizona	Yes	ARS 6-184 (A)(6)	Automatic	No restrictions on wildcard authority, unless activity prohibited by law.
Arkansas	No	N/A	N/A	Limited to activities allowed for national banks.
California	No	N/A	N/A	Any regulation adopted under the authority expires as 12:00 PM on December 31st of the year following the calendar year in which it is promulgated.
Colorado	No	N/A	N/A	Activity must not be prohibited under the banking code and be in accordance with the rules and regulations of the banking board.
Connecticut	No	N/A	N/A	Requires prior written notice to Banking Commissioner who has authority to disapprove the activity no later than 30-days after the notice was filed with the Department of Banking.
Delaware	No	N/A	N/A	In the interest of bank safety and soundness, the Commissioner may require that any permissible activity be conducted through a subsidiary of the bank.
DC	No	N/A	N/A	The activity must be exercised through a subsidiary.
Florida	No	N/A	N/A	Subject to prior approval of the Department pursuant to Administrative Rule or Order of General Application.
Georgia	Yes	OCGA Section 7-1-61	Supervisor's Authorization Required	Department must enact a Rule to establish parity.
Hawaii	No	N/A	N/A	Wildcard approvals are subject to such terms and conditions as the commissioner deems appropriate.
Idaho	Yes	26-1101(3)	Supervisor's Authorization Required	Activities authorized for banks in other states must have been approved by the FDIC.
Illinois	Yes	205 ILCS 5/5(25)	Automatic	Thrift wildcard authority [205 ILCS 5/5(25)] does not extend to the granting of any real estate brokerage authority.
Indiana	No	N/A	N/A	None
Iowa	No	N/A	N/A	Department does not have a "wild card" provision; however, Iowa Code Section 524.102 states intent of competitive equality with banks existing under the laws of other states and the United States.
Kansas	No	N/A	N/A	None
Kentucky	Yes	KRS 287.102	Automatic for 1 and 2 rated banks	None
Louisiana	No	N/A	N/A	Requires bank to notify commissioner, in writing, of intent to exercise such rights, powers, privileges, and immunities. The bank may engage in the activity if the commissioner does not raise an objection within 45 days of receiving a written notice of intent from the bank.
Maine	No	N/A	N/A	None

Wildcard Authority & Parity Statutes – Part III

	Grants State-Chartered Banks Competitive Equality with Any Financial Services Provider	Statute/Citation	Automatic Trigger by OCC or Court, or Supervisor's Determination Required	Restrictions on State's Wildcard Authority
Maryland	No	N/A	N/A	If approval of an additional banking activity is granted, the approval must impose the same conditions that federal law requires or permits as to national banks.
Massachusetts	No	N/A	N/A	None
Michigan	Yes	MCL 487.12204; MCL 487.14101(2)(b)	Supervisor's Authorization Required	Powers must be "consistent with the safe and sound conduct of the business of banking or of a business related or incidental to banking."
Minnesota	No	N/A	N/A	State laws prevail
Mississippi	No	N/A	N/A	Must submit proof that federal counterpart can exercise such right and request parity.
Missouri	No	N/A	N/A	National bank powers are self-executing and notwithstanding other provisions of state law. Federal thrift powers are activated by regulation only and must be consistent with state law.
Montana	No	N/A	N/A	The powers or authority requested must not be expressly prohibited or limited by Montana law.
Nebraska	No	N/A	N/A	Due to state constitution, wild card must be re-enacted annually. New powers are about a year behind; although automatically granted when re-enacted.
Nevada	No	N/A	N/A	None
New Jersey	No	N/A	N/A	Permitted unless contrary to law. NJSA 17:9A-24b.1
New Mexico	Yes	58-1-54 NMSA 1978	Supervisor's Authorization Required	None
New York	No	N/A	N/A	None
North Carolina	No	N/A	N/A	Not applicable for banks. Subject to any limitations & restrictions as the Administrator may prescribe for savings banks and savings & loans
North Dakota	No	N/A	N/A	State Banking Board must approve activity.
Ohio	Yes	1121.05 (A)(4), (5) & (6)	Supervisor's Authorization Required	Superintendent's discretion; parity rules lapse after 30 months; and cannot address matters of interest rates charged
Oklahoma	No	N/A	N/A	Commissioner or Banking Board may limit the bank's activity under the wildcard
Oregon	No	N/A	N/A	None by statute
Pennsylvania	No	N/A	N/A	Notice required to the Department. Department can impose terms or conditions not more restrictive than required under federal law. Department can object based upon safety and soundness concerns.
Puerto Rico	No	N/A	N/A	None
Rhode Island	No	N/A	N/A	Wild card authority applies only with respect to powers authorized for "insured-deposit-taking institutions duly organized under the laws of the United States which are members of the FDIC."
South Dakota	No	N/A	N/A	Must prove it promotes competitive equality and that it would serve the best interests of public.

Wildcard Authority & Parity Statutes – Part III

	Grants State-Chartered Banks Competitive Equality with Any Financial Services Provider	Statute/Citation	Automatic Trigger by OCC or Court, or Supervisor's Determination Required	Restrictions on State's Wildcard Authority
Tennessee	Yes	T.C.A. §45-2-607(d)	Supervisor's Authorization Required	None
Texas	No	TFC §32.010 does provide parity with any insured depository institution operating in the United States, subject to certain limitations.	Supervisor's Authorization Required	Rules may be adopted to implement the method or manner in which a state bank exercises specific "wild card" powers that would be otherwise prohibited under state law, if the rules contain adequate safeguards and controls, consistent with safety and soundness, to address the concern of the legislature evidenced by the state law the rules would impact. Compliance is required with licensing requirements of a functional regulatory agency. Finally, an otherwise authorized activity may be denied with respect to a particular bank for safety and soundness reasons.
Utah	No	N/A	N/A	None
Vermont	No	N/A	N/A	Commissioner's regulatory authority.
Virginia	No	N/A	N/A	Legislature may override Citation 6:1-5.1 and 6.1-58.1 granting state chartered banks competitive equality with the activities of national banks.
Washington	No	N/A	N/A	Activities must be approved by the Director of the Department of Financial Institutions
West Virginia	Yes	§31A-8C-2(e)	Supervisor's Authorization Required	Cannot approve activities involving non-credit insurance project sales or underwriting or certain real estate brokerage activities. A financial institution cannot invest more than 10% of its consolidated capital and surplus in the conduct of financially-related activities.
Wisconsin	Yes	s. 221.0322	Supervisor's Authorization Required	The activities are limited to those specified by rule of the division. Can not approve activity explicitly prohibited by the statutes.
Wyoming	No	N/A	N/A	The Commissioner must approve any activity through rules and regulations.

Yes	No
11	39

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Guam, New Hampshire, South Carolina and Virgin Islands.