The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection

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THE OCC’S PREEMPTION RULES EXCEED THE AGENCY’S AUTHORITY AND PRESENT A SERIOUS THREAT TO THE DUAL BANKING SYSTEM AND CONSUMER PROTECTION

ARTHUR E. WILMARTH, JR.*

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I. Introduction

On January 7, 2004, the Office of the Comptroller of the Currency (‘‘OCC’’) issued new regulations that preempt a broad range of state laws from applying to national banks’ activities.\(^1\) The OCC’s rules declare that state laws are preempted if they “obstruct, impair, or condition a national bank’s ability to fully exercise” its federally-authorized powers, either directly or through operating subsidiaries.\(^2\)


\(^2\) See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1911–13. In an accompany-
As discussed in Part II of this article, the new 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 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 (i) are part of “the legal infrastructure that makes it practicable” for national banks to conduct their federally-authorized activities and (ii) “do not regulate the manner or content of the business of banking authorized for national banks.” The OCC has also claimed that, by virtue of § 7.4006 of its regulations, the new preemption rules will apply to operating subsidiaries of national banks.

As explained in Part II, the OCC has deliberately crafted its rules to accomplish a sweeping preemption of state 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 asserts that it possesses the same authority to override state laws that the OTS has proclaimed in its own regulations.

In a second notice of final rulemaking, also published on January 7, 2004, the OCC amended § 7.4000 of its regulations, which restricts
the exercise of “visitorial powers” over national banks. 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), and does not apportion that responsibility among the OCC and the states . . . .” The amended rule bars state officials from suing in federal or state courts to compel 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 affirming 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. The OCC further claims that its amended visitorial powers rule will operate in conjunction with § 7.4006 of its regulations to “prevent states from exercising visitorial authority over national bank operating subsidiaries.” The OCC’s assertion of exclusive enforcement authority over national banks and their operating subsidiaries encompasses both administrative and judicial proceedings.

Part III of this article contends that the OCC’s new rules, unless overturned by Congress or the courts, will do great harm to the state banking system, thereby threatening the viability of the dual banking system. In addition, application of the OCC’s rules to operating subsidiaries of national banks will seriously impair the states’ ability to regulate state-chartered corporations and protect consumers from illegal, fraudulent, and unfair financial practices. Part III also sets forth several reasons why the OCC’s new rules exceed the boundaries of its statutory authority.

at 12 C.F.R. § 7.4000) [hereinafter OCC Docket 04-03]. These regulations were issued in proposed form at Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 6363 (proposed Feb. 7, 2003) [hereinafter OCC Docket 03-02].

7 12 C.F.R. § 7.4000.
8 OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1895 (emphasis added).
9 See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1911.
10 See id. at 1899–900.
11 12 C.F.R. § 7.4006.
12 OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900.
13 See id. at 1897–900; see also OCC Docket 03-02, supra note 6, 68 Fed. Reg. at 6369–70.
First, as discussed in Part III.A, 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.”\textsuperscript{14} 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.\textsuperscript{15}

Second, as described in Part III.B, Congress has repeatedly acted during the past century to preserve the dual 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,\textsuperscript{16} 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.”\textsuperscript{17} 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.

As discussed in Parts III.C and III.D, the OCC’s regulations conflict with congressional intent and threaten to disrupt the competitive balance that has long existed between national and state banks. 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 incentives to convert to national charters. Over time, it seems likely

\textsuperscript{14} Atherton v. FDIC, 519 U.S. 213, 222 (1997).
that the state banking system will be reduced to a group composed primarily of smaller, community-oriented banks, while the national banking system will be increasingly dominated by large multistate banks. As a consequence, even if the state regulatory system could survive as a chartering authority for community banks, there would 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, responsiveness, and flexibility.

Third, as set forth in Part III.E, 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 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.\(^\text{18}\) 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.

Fourth, as discussed in Part III.F, 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 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’s 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’s comparable power. Accordingly, the OCC’s preemption rules for non-real estate transactions are unlawful.

Fifth, as described in Part III.G, the OCC cannot prevent state officials from filing lawsuits to enforce applicable state laws against

\(^{18}\) See infra notes 287–90, 294–95, and accompanying text (discussing the interagency uniform standards for real estate loans made by federally-insured banks).
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.

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 fees and assessments paid by national banks. 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 initiated a single public prosecution of a major national bank 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 interests (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 constituents.

Finally, as set forth in Part III.H, 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 12 U.S.C. § 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.

II. The OCC’s Preemption Rules Proclaim a Sweeping Preemption of State Laws That Is Comparable in Scope to the “Field Preemption” Regime Established by the OTS’s Rules

In OCC Docket 04-04 the OCC adopted regulations that preempt state laws in four broadly-defined areas—real estate lending, other lending, deposit-taking, and other federally-authorized national bank “activities.”\(^\text{19}\) In all four areas, the OCC’s rules (i) preempt state laws that “obstruct, impair, or condition, a national bank’s ability to fully exercise”\(^\text{20}\) its federally-authorized powers and (ii) permit a narrowly-defined subset of state laws to apply to national banks, but only “to the extent that [such laws] only incidentally affect”\(^\text{21}\) the business of national banks. The preamble to the OCC’s preemption rules declares that state laws will be deemed to have an “incidental” effect on national banks, and will not be preempted, only if such laws (i) “form the legal infrastructure that makes it practicable” for national banks to conduct their federally-authorized activities and (ii) “do not attempt to regulate the manner or content of the business of banking authorized for national banks.”\(^\text{22}\)

As explained above, the OCC’s amended visitorial powers rule asserts that the OCC has the exclusive authority to determine whether to initiate administrative or judicial proceedings to enforce state laws applicable to national banks or their operating subsidiaries.\(^\text{23}\) The OCC also claims that its new preemption and visitorial powers rules apply to operating subsidiaries to the same extent as those rules apply to national banks.\(^\text{24}\) This claim is based on the OCC’s view that

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\(^{20}\) Id. (text of 12 C.F.R. §§ 7.4007(b), 7.4008(d), 7.4009(b), 34.4(a)).

\(^{21}\) Id. (text of 12 C.F.R. §§ 7.4007(c), 7.4008(e), 7.4009(c), 34.4(b)).

\(^{22}\) Id. at 1912–13.

\(^{23}\) See supra notes 6–13 and accompanying text (discussing the OCC’s amendment to § 7.4000).

\(^{24}\) OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1913.
“operating subsidiaries and their parent banks [are] equivalents,” as indicated in § 7.4006 of the OCC’s regulations.25

Unlike the OTS, the OCC has not formally adopted a rule of “field preemption” with regard to lending, deposit-taking, and other business activities of national banks and their operating subsidiaries. Nevertheless, the OCC has asserted a virtually unlimited power to override state laws in order “to enable national banks to operate to the full extent of their powers under Federal law, without interference from inconsistent state laws, consistent with the national character of the national banking system. . . .”26 The OCC has further claimed that its authority to preempt state laws is comparable in scope to that of the OTS, because:

...(continues)
The OCC’s preemption rules give national banks and their operating subsidiaries essentially the same immunity from state laws in the areas of real estate lending, other lending, deposit-taking, and other “activities” that federal savings associations and their operating subsidiaries enjoy under the OTS’s regulations.\textsuperscript{28} The OCC has publicly described its rules as having a preemptive reach that is at least equal to the scope of the OTS’s regulations.\textsuperscript{29}

In sum, the OCC’s preemption rules override all state laws that apply to national banks and their operating subsidiaries, with the exception of two narrowly-defined categories of laws: (i) state-law standards that Congress has expressly incorporated by reference in federal statutes;\textsuperscript{30} and (ii) general state laws—such as contracts, torts, criminal law, the right to collect debts, acquisition and transfer of property, taxation, and zoning—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

\textsuperscript{28} See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1914 (stating that “the preemption regulations adopted by the OCC are substantially identical to the preemption regulations of the OTS”). The OTS has declared 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. §§ 560.2(a), 557.11(b), 545.2. Compare OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1916–17 (text of 12 C.F.R. §§ 7.4007(b)–(c), 7.4008(d)–(e), 7.4009(b)–(c), 34.4), with 12 C.F.R. § 545.2 (OTS rule regarding “operations” of federal savings associations); id. §§ 557.11–557.13 (OTS rules regarding deposit-taking); id. § 560.2 (OTS rule regarding lending). For OCC and OTS regulations that purport to grant operating subsidiaries the same immunity from state law enjoyed by their parent institutions, see 12 C.F.R. § 7.4006 (OCC rule) and 12 C.F.R. § 559.3(n) (OTS rule).

\textsuperscript{29} See OCC, Comparison of the OCC’s Preemption Rules with the OTS’s and NCUA’s Current Rules (Jan. 7, 2004), at http://www.occ.treas.gov (stating that the OCC’s preemption rules override every category of state law that is preempted under the OTS’s regulations and also override two types of state real estate laws that are not preempted by the OTS’s regulations); OCC Issues Final Rules on National Bank Preemption and Visitorial Powers, OCC News Release 2004-3, at 1, 4 (Jan. 7, 2004) [hereinafter OCC NR 2004-3], available at http://www.occ.treas.gov (stating that the OCC’s preemption rule “establishes symmetry with federal thrifts regarding the types of state laws that apply to national banks,” because “the list of preempted state laws [in the OCC’s rule] is nearly identical to the list incorporated into the regulations of the [OTS]”); see also R. Christian Bruce, National Banks: OCC Releases Final Preemption Regulations; Spitzer Says Change Cannot Deter Lawsuits, 82 Banking Rep. (BNA) 57, 57 (2004) (stating that the OCC’s new preemption rules “are important for the OCC itself, which has long sought to match the expansive preemption authority enjoyed by the [OTS]”).

conduct of that business.”

Evidently, in the OCC’s view, all other state laws are barred from applying to national banks and their operating subsidiaries without the express authorization of Congress. By declaring that state laws are applicable only if they “make[] practicable” the business of national banks and are preempted if they “regulate the manner or content” of that business, the OCC has created a regime of field preemption in everything but name.

The OCC’s arguments for its preemption and visitorial powers rules echo similar claims of broad preemptive authority that the OCC has made during the past two years. For example, in a letter written to the Conference of State Bank Supervisors (“CSBS”) in February 2003, the OCC declared: “National banks were established by Congress as instrumentalities to carry out multiple Congressional objectives and were designed to constitute a national banking system, independent of State direction or supervision, operating under Federal standards administered by the OCC.”

In an advisory letter issued in November 2002, the OCC asserted: “Congress provided that the uniform federal standards that would govern national banks—and state laws, where federal law makes them applicable—would be enforced by a single, federal supervisor, the OCC.”

In a speech delivered in February 2002, Comptroller of the Currency John D. Hawke, Jr., argued:

There is no question that 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 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.


32 Cf. id. at 1910–11 (declining to formally “declare that these regulations ‘occupy the field’ of national banks’ real estate lending, other lending, and deposit-taking activities,” but asserting that (i) “state laws do not apply to national banks if they impermissibly contain a bank’s exercise of a federally authorized power” and (ii) “the effect of labeling,” such as the use of the term “occupation of the entire field,” is “largely immaterial in the present circumstances”).


As shown in Part III, the OCC’s novel theory of de facto field preemption is contrary to court decisions and congressional mandates. Those judicial and congressional authorities demonstrate that the OCC’s preemption and visitorial powers rules extend far beyond the OCC’s lawful authority. Unfortunately, several recent victories in federal appellate and district courts have encouraged the OCC to pursue its efforts to prevent the states from exercising any meaningful regulatory authority over national banks and their operating subsidiaries. While state officials should continue to contest the OCC’s claims in court, they also need to persuade Congress to clarify the limits on the OCC’s authority to override state laws.

III. The OCC’s Preemption and Visitorial Powers Rules Exceed the Agency’s Authority, Threaten to Destroy the Dual Banking System, and Undermine the States’ Ability to Protect Consumers

A. The OCC’s Claim that National Banks Are Generally Exempt from State Regulation Is Contrary to Leading Supreme Court Decisions

1. The Supreme Court Has Repeatedly Held that National Banks Are Subject to State Laws

The OCC has declared that “the exercise by Federally-chartered national banks of their Federally-authorized powers is ordinarily not subject to state law.”\(^{36}\) According to the OCC, its preemption rules are justified because they promote “a ‘complete’ national banking system, free from state control, and subject to uniform national standards.”\(^{37}\) These assertions are clearly wrong because they ignore 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.\(^{38}\) Thus, court decisions have frequently upheld the

\(^{36}\) OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,120.

\(^{37}\) Id. at 46,129.

\(^{38}\) As discussed in Part III.B, infra, Congress has allowed (by express mandate or by statutory silence) the states to apply their laws to many operations of national banks. In contrast, the Supreme Court recently determined that 12 U.S.C. §§ 85–86 were intended by Congress to provide “an exclusive federal cause of action for usury against national banks.” Beneficial Nat’l Bank v. Anderson, 539 U.S. 1, 10 (2003) (emphasis
application of state laws to national banks without requiring any explicit incorporation of state-law standards into federal statutes. In 1997, for example, the Supreme Court reaffirmed the general principle that “federally chartered banks are subject to state law.” 39 As support for that principle, the Court cited prior decisions reaching back more than a century to *National Bank v. Kentucky.* 40 In *Kentucky,* 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. 41

In *Kentucky,* the Court expressly distinguished its famous decision in *McCulloch v. Maryland.* 42 In *McCulloch,* the Court struck down a Maryland law that imposed a tax on the Baltimore branch of the Second Bank of the United States. In *Kentucky,* the Court focused on Chief Justice John Marshall’s statement in *McCulloch* that “the power to tax involves the power to destroy.” 43 Based on Marshall’s statement, the Supreme Court held in *Kentucky* that *McCulloch* does not bar state laws from applying to national banks except in situations added). In view of this congressional purpose, the Court held that “there is . . . no such thing as a state-law claim of usury against a national bank.” 44 Thus, usury is a specific area in which Congress has determined that state-law rules should not apply to national banks.

As shown below, Congress has not manifested any intent to provide national banks or their operating subsidiaries with a general exemption from state laws. Moreover, in the area of usury, Congress adopted a statute in 1980 that establishes parity for all FDIC-insured banks with respect to interest rates chargeable on loans. This 1980 statute provides FDIC-insured state banks with the same exemption from state usury laws that national banks enjoy under 12 U.S.C. §§ 85–86. Congress thereby ensured that its specific preemption of state usury laws would not give national banks a decisive competitive advantage over state banks. See infra notes 124–26 and accompanying text (discussing 12 U.S.C. § 1831d).

41 Id. at 362; quoted in Atherton, 519 U.S. at 222–23.
43 Id. at 431.
where a state regulation “may be so used . . . as to destroy” the ability of national banks to exercise their federally-authorized powers:

[I]t is argued that the [national] banks, being instrumentalities of the Federal government, by which some of its important operations are conducted, cannot be subjected to such State legislation. It is certainly true that the [Second] Bank of the United States and its capital were held to be exempt from State taxation on the ground here stated, and this principle, laid down in the case of McCulloch v. The State of Maryland, has been repeatedly affirmed by the court. But the doctrine has its foundation in the proposition, that the right of taxation may be so used in such cases as to destroy the instrumentalities by which the [federal] government proposes to effect its lawful purposes in the States, and it certainly cannot be maintained that banks or other corporations or instrumentalities of the [federal] government are to be wholly withdrawn from the operation of State legislation. . . . [T]he 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. Any other rule would convert a principle founded alone in the necessity of securing to the government of the United States the means of exercising its legitimate powers, into an unauthorized and unjustifiable invasion of the rights of the States. 44

As shown by the foregoing excerpts from Kentucky, McCulloch prohibits the states from enforcing only such laws as are likely to “incapacitate[] the [national] banks from discharging their duties to the [federal] government.” 45 Furthermore, as Kentucky makes clear, McCulloch does not exempt national banks from their general duty of complying with reasonable and nondiscriminatory state laws. 46 In Atherton 47 the Supreme Court reaffirmed this understanding of McCulloch as set forth in Kentucky. Thus, both Kentucky and Atherton establish that McCulloch does not bar the general application of state laws to national banks.

44 Nat’l Bank v. Kentucky, 76 U.S. at 361–62 (emphasis added). The Supreme Court reaffirmed the principles of National Bank v. Kentucky seven years later in Waite v. Dowley, 94 U.S. 527 (1877). In Waite, the Court upheld the validity of a Vermont law that required all banks, including national banks, to provide the names of their resident shareholders to local officials responsible for collecting Vermont’s tax on bank shares. 94 U.S. at 533–34.


46 Id.

47 Atherton, 519 U.S. at 222–23.
In its notice of proposed rulemaking, the OCC quoted _McCulloch_ as support for its claim that states “have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of an entity created under Federal law.” However, in view of the Court’s subsequent decisions in _Kentucky_ and _Atherton_, this quote from _McCulloch_ cannot reasonably be interpreted as providing national banks with a general immunity from state regulation. The _McCulloch_ decision dealt with the Second Bank of the United States, an institution that was partly owned by the federal government, served as the government’s fiscal agent, and operated as a de facto central bank. In _Osborn v. Bank of the United States_, Chief Justice Marshall declared that the Second Bank “would certainly be 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.” In Marshall’s view, the Second Bank was totally exempt from state taxation because it was “a public corporation, created for public and national purposes . . . [as] the great instrument by which the fiscal operations of the government are effected.” Thus,

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49 One-fifth of the Second Bank’s stock was owned by the federal government. The Second Bank served as the depositary and paying agent for the federal government. Additionally, the Second Bank regulated the nation’s currency supply (i) by issuing its own notes (which accounted for about one-fourth of the paper currency issued by all U.S. banks) and (ii) by presenting state bank notes for redemption in specie by the issuing banks. Nicholas Biddle, president of the Second Bank from 1823 to the Bank’s demise in 1836, followed policies that were consciously designed to make the Bank “a central bank with effective power over the nation’s money market.” _Paul Studenski & Herman E. Krooss, Financial History of the United States_ 83–88, 103–07 (2d ed. 1963) (quote at 87); _Herman E. Krooss & Martin R. Blyn, A History of Financial Intermediaries_ 44–45, 52–54 (1971); _Arthur E. Wilmath, Jr., The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System_, 58 Fordham L. Rev. 1133, 1153 (1990) [hereinafter Wilmath, Dual Banking System]; _Arthur E. Wilmath, Jr., Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks_, 77 Iowa L. Rev. 957, 970 (1992) [hereinafter Wilmath, Too Big to Fail].

50 22 U.S. (9 Wheat.) 738 (1824).

51 _Id._ at 859; see _Michael P. Malloy, Principles of Bank Regulation_ 6–7 (2d ed. 2003) (discussing _Osborn_).

52 _Osborn_, 22 U.S. at 860 (describing the Second Bank at 863 as “a machine for the money transactions of the [federal] government”).
Marshall sharply distinguished the public functions of the Second Bank from “the mere business of banking [that] is, in its own nature, a private business.”

In *Osborn*, Marshall acknowledged that the Second Bank was “transacting private as well as public business” by “lending and dealing in money.” He argued, however, that the private activities of the Second Bank were “inseparably connected” to its “public functions” because its private business supported “the currency in which all transactions of the [federal] government are conducted.” Accordingly, Marshall concluded that the Second Bank’s “capacity of carrying on the trade of banking” was “essential to its character, as a machine for the fiscal operations of the government.” Based on this essential connection between the Second Bank’s “trade of banking” and its public fiscal operations, Marshall held that the Bank’s “trade must be as exempt from State control as the actual conveyance of the public money.”

The Second Bank of the United States was a far different institution from today’s national banks. All national banks currently operate as privately-owned corporations for the benefit of their shareholders. Since Congress adopted the Federal Reserve Act of 1913 (“FRA”), the Federal Reserve System (“FRS”) has performed all central banking functions for the nation. A central objective of the FRA was to provide the FRS with sole control over the nation’s money supply, thereby terminating the roles that national banks had previously played in funding government operations and issuing a national currency under the original National Bank Act of 1864 (“NBA”).

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53 *Id.*

54 *Id.* at 860–61.

55 *Id.* at 863.

56 *Id.* at 867.

57 *Id.*


60 *National Bank Act*, ch. 106, 13 Stat. 99 (1864) (codified as amended in 12 U.S.C.). Under the original NBA, national banks were the principal purchasers of U.S. government bonds and issued bank notes backed by those bonds. The NBA’s sponsors intended that the newly-created national banks would promote the federal government’s funding operations for the Civil War and would also help the nation to maintain a more stable supply of currency. However, national banks lost their role as the primary...
As a consequence of the FRA, present-day national banks do not perform any of the public functions that were exercised by either the Second Bank of the United States or the system of national banks created under the original NBA. Today’s national banks cannot be fairly viewed as public institutions comparable to the Second Bank of the United States. Therefore, the OCC’s attempt to justify its preemption rules by citing McCulloch is unpersuasive. Similarly, the OCC cannot validate its regulations by citing other Supreme Court decisions that were decided before 1913, when national banks were still performing important public functions through their government funding and currency operations.

Issuers of the nation’s currency after the FRA was enacted in 1913. Since 1913, Federal Reserve notes have functioned as the nation’s currency in place of the superseded national bank notes. See, e.g., Tiffany v. Nat’l Bank of Mo., 85 U.S. (18 Wall.) 409, 413 (1874) (stating that, under the original NBA, national banks were “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”); MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867–1960, at 196 (Princeton Univ. Press 1963) (observing that the FRA “greatly reduced the importance of the distinction between national and nonnational banks”); KROOSS & BLYN, supra note 49, at 96–100, 118–21; MALLOY, supra note 51, at 10–11; STUDENSKI & KROOSS, supra note 49, at 258–61; Wilmuth, Dual Banking System, supra note 49, at 1153–54; Wilmuth, Too Big to Fail, supra note 49, at 972.

61 See OCC Docket 03–16, supra note 1, 68 Fed. Reg. at 46,121 (quoting Easton v. Iowa, 188 U.S. 220, 229, 231–32 (1903); Farmers & Mechanics Nat’l Bank v. Dearing, 91 U.S. 29, 33, 34 (1875)); 2003 OCC Dual Banking Paper, supra note 48, at 19–20. In Easton, the Supreme Court quoted the important distinction made by Chief Justice Marshall in Osborn between a private corporation carrying on the “mere business of banking” and a public corporation that is “an instrument which is ‘necessary and proper for carrying into effect the powers vested in the government of the United States.’ ” Easton, 188 U.S. at 230. The Court held that national banks established under the original NBA were public institutions within Marshall’s description. Easton, 188 U.S. at 229–30. In Farmers & Mechanics, the Court cited Osborn and explained that national banks were “instruments designed to be used to aid the government in the administration of an important branch of the public service.” Farmers & Mechanics, 91 U.S. at 33 (quoted in Easton, 188 U.S. at 230). Given the Court’s reliance in Easton and Farmers & Mechanics on Marshall’s distinction between private and public banking institutions, the Court might have applied a more tolerant preemption standard in those cases if, at the time, national banks were engaged only in private, for-profit activities and were not involved in currency or government funding operations.

In the preamble to its final preemption rules, the OCC referred to the Supreme Court’s statement in National Bank v. Kentucky that “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
In *First Agricultural National Bank of Berkshire County v. State Tax Commission*, 62 decided in 1968, three dissenting Supreme Court Justices argued that, by reason of the FRA, national banks had become completely private institutions and should no longer be viewed as “tax-immune federal instrumentalities” under the principles announced in *McCulloch* and *Osborn*:

[A] national bank [today] cannot be considered a tax-immune federal instrumentality. It is a privately owned corporation existing for the private profit of its shareholders. It performs no significant federal governmental function that is not performed equally by state-chartered banks. Government officials do not run its day-to-day operations nor does the Government have any ownership interest in a national bank.

... [T]he fact that [national banks] ‘owe their very existence to,’ i.e., are chartered by, the [federal] Government, has been definitively rejected as a basis alone for determining that they should be tax immune. Similarly, a whole host of businesses and institutions are subject to extensive federal regulation and that has never been thought to bring them within the scope of the ‘federal instrumentalities’ doctrine. 63

The majority in *First Agricultural National Bank* (consisting of five Justices) did not reply to the dissenters’ argument. Instead, the majority found it “unnecessary to reach the constitutional question of whether today national banks should be considered nontaxable as federal instrumentalities.” 64 The majority relied on 12 U.S.C. § 548, which at the time allowed states to tax national banks in four specified areas.
The majority concluded that Congress intended § 548 to define “the outer limit within which States can tax national banks.”

In 1969 Congress responded to First Agricultural National Bank by amending § 548. As amended, § 548 provides that every national bank is subject to state taxation to the same extent as a state bank whose principal office is located in the same state. In adopting the 1969 amendment, Congress determined that the reasoning of McCulloch and Osborn no longer justified giving national banks “immunities from State taxation” that were not available to similarly-situated state banks. The Ninth Circuit subsequently held that “the general purpose of [the 1969 amendment] was to promote equality in state taxation of state banks vis-à-vis national banks.”

Based on the analysis employed by Chief Justice Marshall in Osborn, present-day national banks should be considered private corporations that are engaged in the “mere business of banking” with a “principal object [of] individual trade and individual profit.” Accordingly, today’s national banks should be viewed as private entities that are subject to reasonable state regulation.

65 Id. at 345. In contrast to the majority, the three dissenters contended that Congress, by specifying four permissible types of state taxes in § 548, did not intend to preclude all other forms of “nondiscriminatory state taxation” of national banks. Id. at 358–59 (Marshall, J., dissenting).


67 Id. at 459–61.


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.


69 State Board of Equalization, 639 F.2d at 464.


71 Id. at 859–60, 863–68. Mr. Cayne and Ms. Perkins acknowledge that “national
seemed to adopt this view in 1969 when it amended § 548 to make clear that national banks are subject to nondiscriminatory state taxes.

The conclusion that McCulloch does not provide modern national banks with blanket immunity from state regulation is also made clear by the Supreme Court’s 1996 decision in *Barnett Bank of Marion County v. Nelson.* In *Barnett* the Supreme Court 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 “[i]t is 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.”

banks no longer serve in a currency-issuing role as they did at the outset of their establishment.” Cayne & Perkins, supra note 2, at 393. Nevertheless, they contend that the dissent in *First Agricultural National Bank* supports only the application of state tax laws to national banks. Id. This claim overlooks two important points. First, far from being a trivial matter, the immunity of federally-chartered banks from state taxation was a fundamental issue at stake in *McCulloch* and *Osborn,* and also in the congressional debates over the original NBA. See supra notes 42–43, 49–57 and accompanying text (discussing the tax immunity issue involved in *McCulloch* and *Osborn*); Cayne & Perkins, supra note 2, at 393 n.123 (quoting Senator Sumner’s 1864 speech declaring that national banks must be immune from “local taxation” because of their role in “creating a new currency”). Second, the reasoning of the dissent in *First Agricultural National Bank* has a potential application that extends well beyond the issue of state taxation. The dissent argued persuasively that modern national banks should no longer be treated as “federal instrumentalities” because they are private, for-profit business entities that do not conduct any of the “public” functions carried on by the Second Bank of the United States or by national banks prior to 1913. 392 U.S. at 349–59 (Marshall, J., dissenting). Similarly, in *Osborn,* Chief Justice Marshall described the “mere business of banking” as a “private business” that could lawfully be “taxed, regulated, or restrained” by the states, even if that business was conducted by a corporation holding a federal charter, as long as the corporation did not carry out important “public” functions designated by Congress. See 22 U.S. at 860, 862 (stating that “[w]e do not maintain that the corporate character of the Bank exempts its operations from the action of State authority”). Likewise, when Congress subjected national banks to nondiscriminatory state taxes in 1969, Congress indicated that modern national banks should no longer expect to receive special “privileges and immunities” that are denied to state banks. See supra note 68 (quoting the 1969 Senate committee report). Thus, all of the foregoing authorities can reasonably be interpreted as supporting my view that modern national banks are subject to reasonable state regulation, unless a particular state law creates an irreconcilable conflict with a congressional mandate.

73 Id. at 33.
74 Id. (emphasis added).
As the Supreme Court made clear in *Barnett*, the NBA does not create a regime of field preemption, and, therefore, state laws are preempted only when they create an “irreconcilable conflict” with federal statutes governing the operations of national banks.\(^{75}\) In *Barnett* and *Atherton* the Court cited several of its earlier decisions that required national banks to comply with state laws that did not create any impermissible conflict with federal statutes.\(^{76}\) In those earlier 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.”\(^{77}\)

2. The OCC’s Rules Contravene the Standards for Preemption Established by the Supreme Court with Respect to National Banks

As shown in the preceding section, the Supreme Court has made clear in *Barnett* and other decisions that state laws apply to national banks unless they either (i) prevent a national bank from exercising a federally-authorized power,\(^{78}\) or (ii) significantly interfere with the

\(^{75}\) *Id.* at 31 (explaining the difference between field preemption and conflict preemption).

\(^{76}\) *Id.* at 33–34; *Atherton v. FDIC*, 519 U.S. 213, 222–23 (1997).


Three Supreme Court decisions that the OCC has frequently cited actually agree with the standard articulated in *Luckett*. *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 287 (1896) (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”); *First Nat’l Bank of San Jose v. California*, 262 U.S. 366, 368–69 (1923) (recognizing that “[the] contracts and dealings [of national banks] are subject to the operation of general and undiscriminating state laws which do not conflict with the letter or the general object and purposes of congressional legislation”); *Franklin Nat’l Bank v. New York*, 347 U.S. 373, 378 n.7 (1954) (noting that “national banks may be subject to some state laws in the normal course of business if there is no conflict with federal law,” even if Congress has not incorporated such state laws into the NBA).

\(^{78}\) *E.g.*, *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 33 (1996). In OCC Docket 03-16, *supra* note 1, 68 Fed. Reg. at 46,121, the OCC quoted the Court’s statement in *Barnett* 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. The OCC reads this statement far too broadly in claiming that it gives national banks a general exemption from state regulation. What *Barnett* actually said was that a state may not seek to prohibit the use of a
bank’s exercise of that power. To remove all doubt that the Supreme Court intended this formulation to provide the governing preemption standard, the Court in Barnett also used the synonymous phrase barring the states from acting “to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.” Remarkably, the OCC does not follow either standard in its preemption rules. Instead, the OCC declares that state laws are preempted if they “obstruct, impair, or condition a national bank’s ability to fully exercise the powers authorized to it under Federal law.”

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79 E.g., Barnett, 517 U.S. at 33. In OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,121, the OCC also quoted the Court’s statement in Barnett that “the Federal Statute removes only federal legal obstacles, not state legal obstacles, to the sale of insurance by national banks”). Barnett did not say that a state may never affect the exercise of a federal power by requiring national banks, in the course of using that power, to satisfy reasonable “conditions” that all similarly-situated persons must meet.

80 Barnett, 517 U.S. at 33 (emphasis added). Mr. Cayne and Ms. Perkins claim that I have “distort[ed] key aspects” of the Barnett opinion, and that I “erroneously” interpret Barnett as “establishing a presumption against preemption of state law as applied to national banks.” Cayne & Perkins, supra note 2, at 370 (emphasis in original). This charge is unfounded for three reasons. First, Barnett used the same formulation twice (“forbid, or . . . impair significantly”; “prevent or significantly interfere with”) to make clear that state laws do apply to national banks unless they create a significant conflict with federal law. See supra notes 73–74, 78–80 and accompanying text. Second, Congress specifically endorsed the “prevent or significantly interfere with” formulation as the governing preemption standard under Barnett. See infra notes 84–85 and accompanying text. Third, Barnett cited three earlier Supreme Court decisions as authority for the “prevent or significantly interfere with” test for preemption. Those earlier cases do uphold the presumptive application of state laws to national banks. Barnett, 517 U.S. at 33–34 (citing Luckett, McClellan, and Kentucky); see also supra notes 40–44 and accompanying text (discussing Kentucky); infra notes 86–92, 101–06, 152, 172 and accompanying text (discussing McClellan and Luckett).

81 OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1912; see id. at 1916–17 (text of 12 C.F.R. §§ 7.4007(b), 7.4008(d)(1), 7.4009(b), 34.4(a)).
The OCC’s “obstruct, impair, or condition” standard for preemption appears nowhere in Barnett. Unless it is overturned by Congress or the courts, the OCC’s self-created preemption standard will obviously have a far greater impact in preempting state laws than the “prevent or significantly interfere” rule that the Supreme Court actually adopted in Barnett. Under the OCC’s newly-invented standard, state laws would be preempted if they have any impact on national banks other than merely an “incidental” effect that “makes it practicable” for national banks to conduct their business.82 In contrast, under the Barnett standard state laws apply to national banks unless they either prevent or significantly interfere with the exercise of a congressionally-authorized power.

In 1999 Congress adopted the Gramm-Leach-Bliley Act (“GLBA”),83 which regulates, among other things, the sale of insurance products by depository institutions and their affiliates.84 GLBA contains a specific preemption provision that governs the application of state laws to the sale or marketing of insurance products by depository institutions and their affiliates. This provision declares that “the legal standards for preemption set forth in the decision of the Supreme Court of the United States in [Barnett] mean that no State may . . . prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage, directly or

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82 Id. at 1912; see OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1896, 1896 n.7 (explaining that, under the OCC’s preemption rules, state laws will apply to national banks only if such laws establish “the legal infrastructure that surrounds and supports the ability of national banks—and others—to do business”).


84 For a discussion of GLBA’s provisions allowing depository institutions to sell insurance and affiliate with insurance underwriters, see Lissa L. Broome & Jerry W. Markham, Banking and Insurance: Before and After the Gramm-Leach-Bliley Act, 25 IOWA J. CORP. L. 723, 757–61 (2000).
indirectly, . . . in any insurance sales, solicitation or cross-marketing activity.”

85 Thus, Congress expressly endorsed the “prevent or significantly interfere with” standard for preemption, which the Supreme Court articulated in Barnett. In view of this congressional endorsement of the Barnett standard, the OCC has no authority to invent its own “obstruct, impair, or condition” preemption test.

The OCC’s self-created standard is also contrary to several Supreme Court decisions that held that national banks must comply with state laws that imposed reasonable, nondiscriminatory conditions and limitations on the ability of national banks to exercise their federal powers. For example, in McClellan a Massachusetts law prohibited insolvent debtors from making preferential transfers of property to any creditor. 86 A national bank claimed that its power to accept conveyances of real estate as security for debts under Rev. Stat. § 5137 (the predecessor to 12 U.S.C. § 29) preempted the state statute and permitted the bank to accept a preferential transfer of land from an insolvent borrower. 87 The NBA was silent on the issue of whether a state could place restrictions on transfers of real estate to national banks. The national bank argued that the NBA’s failure to include an express reference to state law in Rev. Stat. § 5137 meant that the NBA was “exclusive of any [state] legislation” in allowing national banks “to take securities for past debts by a conveyance of land, either directly or in mortgage.” 88 The Supreme Court, however, rejected the bank’s “assertion that national banks in virtue of the [NBA] are entirely removed, as to all their contracts, from any and every control by the state law.” 89 Following the rule announced in National Bank v. Kentucky, the Court declared that the purpose of the NBA “was to leave such banks as to their contracts in general under the operation of the state law.” 90 Accordingly, the Court held that state laws govern the business transactions of national banks unless (i) Congress has “expressly . . . directed” that state law should be preempted or (ii) a state law “frustrates the lawful purpose of Congress or impairs the


87 Id.

88 Id. at 352–54 (argument by counsel for the bank).

89 Id. at 359.

90 Id.; see id. at 356–57.
efficiency of the banks to discharge the duties imposed upon them by [federal law].” 91 The Court found “no conflict between the special power conferred by Congress upon national banks to take real estate for certain purposes, and the general and undiscriminating law of the State of Massachusetts subjecting the taking of real estate to certain restrictions, in order to prevent preferences in case of insolvency.” 92

In First National Bank in St. Louis v. Missouri 93 the Supreme Court rejected a similar field preemption claim asserted by the defendant national bank. 94 In overruling the bank’s argument, the Court declared 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.” 95

The Supreme Court reiterated the core principles of Kentucky, McClellan, and St. Louis in subsequent decisions. For example, in Lewis v. Fidelity & Deposit Co. 96 the receiver for an insolvent national bank argued that the bank, in accepting deposits of state funds, had no power to provide the surety bond required by state law. 97 The receiver asserted that “a national bank is an instrumentality of the United States and cannot subject itself by contract to the laws of a State.” 98 The Supreme Court overruled that argument in the following terms:

[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. . . . What obligations to the State the bank assumes may be defined by the law of that State. It is quite possible that the legislature might attempt to impose, under the conditions of the bond, a duty which the bank would be without authority to undertake; and to that extent the contract would be unenforceable. But it is not shown that the obligations as now defined

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91 Id. at 359.
92 Id. at 361 (emphasis added).
93 263 U.S. 640 (1924).
94 See id. at 643 (summarizing argument by the bank’s counsel, who contended that “Congress, having defined the powers of the [national] bank, . . . occupied the entire field of legislation on that subject”).
95 Id. at 656 (emphasis added).
96 292 U.S. 559 (1934).
97 Id. at 564–71.
98 Id. at 566.
by the courts of Georgia are contrary to anything in the National Bank Act. 99

Thus, Lewis expressly upheld the state’s authority to impose conditions on the terms of its deposit relationship with a national bank, as long as those conditions did not create an impermissible conflict with the NBA. 100

Similarly, in Anderson National Bank v. Luckett 101 the Court upheld a Kentucky law that required all banks, including national banks, to transfer dormant bank accounts to the state so that the state could initiate judicial proceedings to determine whether those accounts were abandoned and should escheat to the state. 102 Again, the NBA was silent on the question of whether states could apply their escheat laws to deposits held by national banks. However, the Court rejected the plaintiff national bank’s argument that the Kentucky statute created an unconstitutional burden on the authority of national banks to accept deposits under 12 U.S.C. § 24(Seventh). 103 The Court found that the Kentucky statute did not discriminate against national banks or conflict with any specific provision of the NBA. 104 The Court further declared that bank deposits are “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 [state] laws of this type are so burdensome as to be inapplicable to the accounts of depositors in national banks.” 105

99 Id. at 566 (1934) (citing Nat’l Bank v. Kentucky, 76 U.S. (9 Wall.) 353, 361 (1869); McClellan v. Chipman, 164 U.S. 347, 356 (1896); St. Louis, 263 U.S. at 656).
100 Id.
102 Id. at 252–53.
103 Id. at 236, 252–53.
104 Id. at 247–48.
105 Id. at 248. In Luckett, the Court carefully distinguished First National Bank of San Jose v. California, 262 U.S. 366 (1923), a case that the OCC has frequently cited in support of its broad preemption theory. Luckett, 321 U.S. at 250. In San Jose the challenged California statute required the automatic escheat to the state of inactive bank accounts without any proof that the accounts were actually abandoned. San Jose, 262 U.S. at 366. As the Court explained in Luckett, the California law in San Jose was declared unconstitutional because the seizure and escheat of bank accounts for “mere dormancy” was “so unusual and so harsh . . . as to deter [depositors] from placing or keeping their funds in national banks.” Luckett, 321 U.S. at 250. By contrast, the Kentucky law upheld in Luckett (i) required the state to maintain “protective [state] custody of long inactive bank accounts” in a manner that could “operate for the benefit and security of depositors” and (ii) permitted the state to escheat only those accounts
The foregoing Supreme Court decisions preclude the OCC from adopting its sweeping preemption rules, which, as shown above in Part II, amount to de facto field preemption. The OCC’s rules are based on an aggressively preemptive construction of the NBA that the Supreme Court has repeatedly rejected. In contrast to the OCC’s position, the Court’s decisions establish that state laws do apply to national banks unless they create an irreconcilable conflict with the NBA by (i) discriminating against national banks or (ii) preventing or significantly interfering with the banks’ ability to exercise a specific, congressionally-authorized power.\footnote{106 See the discussion above in this Part III.A with respect to \textit{National Bank v. Kentucky}, 76 U.S. (9 Wall.) 353, 362 (1869), \textit{Waite v. Dowley}, 94 U.S. 527, 533 (1877), \textit{McClenan v. Chipman}, 164 U.S. 347, 361 (1896), \textit{First National Bank in St. Louis v. Missouri}, 263 U.S. 640, 656 (1924), \textit{Lewis v. Fidelity & Deposit Co.}, 292 U.S. 566 (1934), \textit{Luckett}, 321 U.S. at 248, and \textit{Atherton v. FDIC}, 519 U.S. 213, 222–23 (1997). In cases where the Supreme Court found that federal law did preempt a state statute, the Court determined that the challenged state laws either discriminated against national banks, or prohibited or significantly impaired the exercise of an express power granted to national banks under federal law. Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 31–32 (1996) (invalidating a Florida law that prohibited national banks from exercising their express authority to sell insurance in towns with populations of less than 5000 under 12 U.S.C. § 92); Franklin Nat’l Bank v. New York, 347 U.S. 373, 374 (1954) (striking down a New York law that favored state-chartered savings banks and prohibited national banks from using advertising to promote their express power to accept “savings deposits” under former 12 U.S.C. § 371); \textit{San Jose}, 262 U.S. at 370 (invalidating a California statute that escheated bank accounts to the state upon mere dormancy for a specified period and without any proof of abandonment, because the state law threatened a “possible confiscation” of depositors’ funds and thereby significantly interfered with national banks’ ability to exercise their express authority to accept deposits); \textit{Davis v. Elmira Sav. Bank}, 161 U.S. 275, 283 (1896) (striking down a New York law requiring receivers of insolvent national banks to give priority to deposit claims by state-chartered savings banks; \textit{held}, the state law violated the NBA’s \textit{express} command that the OCC, as receiver for national banks, must make a “ratable distribution” to all creditors); \textit{Easton v. Iowa}, 188 U.S. 220, 230 (1903) (invalidating Iowa statutes that prohibited insolvent national banks from accepting deposits and imposed criminal penalties for violations on officers of national banks; \textit{held}, the state laws significantly interfered with the NBA’s \textit{express} grant of \textit{exclusive} authority to the OCC to determine whether a national bank was insolvent and, if so, to supervise the winding up of its business and liquidation of its assets); Farmers’ & Mechanics’ Nat’l Bank v. Dearing, 91 U.S. 29, 35 (1875) (invalidating a New York law that required national banks to forfeit the principal of usurious loans, because that forfeiture penalty was contrary to the \textit{express} terms of section 30 of the NBA, codified at 12 U.S.C. §§ 85–86).}
B. In Order to Maintain Competitive Balance Within the Dual Banking System, Congress Has Endorsed the General Application of State Laws to National Banks

1. Since 1910 Congress Has Followed a Policy Designed to Maintain a Competitive Equilibrium within the Dual Banking System

As the OCC has noted, many members of Congress expected that the new national banking system created in 1863 would “supersede the existing system of State banks.”107 Contrary to this expectation, only a small number of state banks voluntarily chose to convert to national charters.108 In 1865 Congress attempted to drive state banks out of business by imposing a punitive ten percent tax on state bank notes.109 State banks survived, however, by shifting from a note-based business to a deposit-based system based on checking accounts.110 State legislatures also enhanced the attractiveness of state bank charters by allowing state banks to establish branches, to make real estate loans, and to offer trust services.111 National banks found themselves at a serious competitive disadvantage because they could not perform any of these functions under the original NBA. As a result,

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107 OCC Docket No. 04-03, supra note 6, at 1898; see also OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,120 n.5; 2003 OCC Dual Banking Paper, supra note 48, at 16.


109 Id. Like the OCC, Mr. Cayne and Ms. Perkins argue that the legislative history of the original NBA reveals a congressional purpose to “insulate” the newly-created national banks from “interference” by state officials. Compare Cayne & Perkins, supra note 2, at 393, with OCC materials cited supra note 107. Also like the OCC, Mr. Cayne and Ms. Perkins deemphasize the subsequent history of the dual banking system described in Part III of this article. That history shows that, at least since 1910, (i) Congress has repeatedly acted to preserve a basic equality of competitive opportunities between national and state banks and (ii) the competitive equilibrium intended by Congress has depended to a significant degree on the general application of state laws to national banks.

110 Wilmarth, Dual Banking System, supra note 49, at 1154; see also WILLIAM J. BROWN, THE DUAL BANKING SYSTEM IN THE UNITED STATES 14 (table 1) (showing that the number of state banks fell from 1,466 in 1863 to 247 in 1868, before rising to 650 by 1880); FRIEDMAN & SCHWARTZ, supra note 60, at 18–19; ROBERT E. LITAN, WHAT SHOULD BANKS DO? 21 (Brookings Inst. 1987); STUDENSKI & KROOSS, supra note 49, at 178.

111 E.g., LITAN, supra note 110, at 21–22; Wilmarth, Too Big to Fail, supra note 49, at 976.
the state banking system controlled about two-thirds of the bank charters and bank deposits by 1910.\textsuperscript{112}

Between 1913 and 1933, Congress responded to repeated demands from national banks for new powers to meet the competitive threat posed by state banks. Significantly, however, Congress did not repeat its previous efforts to destroy the state banking system. Instead, Congress adopted a series of banking statutes designed to establish a basic equality of competitive opportunities between national and state banks. For example, Congress granted to national banks intrastate branching privileges, fiduciary powers, and real estate lending authorities that were essentially equivalent to those enjoyed by state banks.\textsuperscript{113}

In 1933 Congress rejected proposals by Senator Carter Glass, Federal Reserve Governor Eugene Meyer, and others to create a unified national banking system under federal supervision.\textsuperscript{114} Proponents of a unified system advocated (i) a statute permitting national banks to establish interstate branches without regard to state laws and (ii) a federal deposit insurance program limited to banks that were members of the FRS.\textsuperscript{115} Defenders of the dual banking system argued that such measures would “wipe out the State banking system . . . by giving the national system such an advantage that the competitive State system can not exist.”\textsuperscript{116} Congress chose to preserve the dual banking system, because it (i) rejected proposals for \textit{interstate} branching by national banks, (ii) allowed national banks to establish only such \textit{intrastate} branches as similarly-situated state banks could operate.

\begin{itemize}
\item \textsuperscript{112} See, e.g., \textsc{Brown}, supra note 110, at 13–15 (table 1) (showing that there were 14,348 state banks and 7138 national banks in 1910); \textsc{Krooss & Blyn}, supra note 49, at 135; \textsc{Studeksi & Krooss}, supra note 49, at 246 (reporting that state banks held almost seventy percent of all bank deposits in 1908); Wilmarth, \textit{Too Big to Fail}, supra note 49, at 972.
\item \textsuperscript{113} See, e.g., \textsc{Litan}, supra note 110, at 22, 24; \textsc{H. Parker Willis & John M. Chapman}, \textsc{The Banking Situation} 215–19, 398–408, 585–91 (1934). In the areas of intrastate branching and fiduciary activities, Congress ensured equal treatment of national and state banks by incorporating state-law standards into the statutes governing national banks. See 12 U.S.C. §§ 36(c), 92(a) (2000).
\item \textsuperscript{114} \textsc{S. Rep. No. 72-584}, pt. 2, at 1 (1932) (minority views); Wilmarth, \textit{Too Big to Fail}, supra note 49, at 972–74 (discussing the strong opposition to those proposals).
\item \textsuperscript{115} \textsc{Brown}, supra note 110, at 28–31 (describing proposals for a unified national banking system presented during 1931–1933).
\item \textsuperscript{116} \textsc{S. Rep. No. 72-584}, pt. 2, at 1, 3–7 (arguing against interstate branching powers and against a deposit insurance program limited to national banks).
\end{itemize}
under state law, and (iii) authorized deposit insurance for all national and state banks that could meet the FDIC’s criteria for insurance.  

Since 1933 Congress has continued to maintain a competitive equilibrium within the dual banking system. For example, in 1950 and 1952 Congress adopted statutes ensuring that national banks and state banks would have equivalent opportunities to convert their charters or to enter into mergers with each other. Similarly, in 1969, as discussed above, Congress passed legislation to equalize the treatment of state banks and national banks under state tax laws.

In 1980 Congress adopted three provisions designed to eliminate serious competitive disparities between the national and state systems. First, Congress gave all federally-insured depository institutions (whether operating under federal or state charters) the ability to provide negotiable order of withdrawal (“NOW”) accounts to individuals and nonprofit organizations. NOW accounts, which are functionally equivalent to interest-bearing checking accounts, were first offered by state-chartered banks in New England and New York pursuant to state law. Congress determined in 1980 that all federally-insured institutions should have an equal opportunity to offer such accounts.

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117 See, e.g., Brown, supra note 110, at 18–19, 28–31; Friedman & Schwartz, supra note 60, at 434–37; Carter H. Golembe, The Deposit Insurance Legislation of 1933: An Examination of Its Antecedents and Its Purpose, 75 POL. SCI. Q. 181, 195–200 (1960); Wilmuth, Too Big to Fail, supra note 49, at 973–75.


accounts. Second, Congress required all federally-insured depository institutions to comply with the reserve requirements of the FRS. As a justification for applying FRS reserve requirements to state nonmember banks, Congress determined that the prior exemption of those banks from reserve requirements had given them a significant competitive advantage over national banks and state member banks.

Third, in 1980 Congress adopted a provision ensuring equal treatment for FDIC-insured state banks in the area of interest rate limits for loans. The Supreme Court held in 1874 and again in 1978 that 12 U.S.C. §§ 85 and 86 under the NBA provided “advantages to National banks over their State competitors” by exempting them from state usury laws. This exemption from state usury limits gave national banks a major competitive advantage when interest rates rose sharply during the late 1970s. In order to remove the resulting competitive disparity between national banks and state banks, Congress adopted 12 U.S.C. § 1831d in 1980. Section 1831d provides “parity” for all FDIC-insured, state-chartered depository institutions because it allows them to take advantage of the same federal usury standards that apply to national banks under §§ 85 and 86.

122 See id.


It is noteworthy that § 1831d preempted only the limitations on loan interest rates imposed by state usury laws, and Congress deliberately avoided any broader preemption of state laws governing non-interest charges. Thus, Congress’s action in 1980 was entirely consistent with its longstanding policy of preserving the general application of state laws to the activities of national and state banks. See Perdue v. Crocker Nat’l Bank, 702 F.2d 503, 517, 522–23 (Cal. 1985), appeal dismissed, 475 U.S. 1001 (1986).
Thus, even in the area of usury where the NBA expressly preempted the application of state laws to national banks, Congress eventually restored a competitive balance by adopting a parallel preemption in favor of state banks. Similarly, in 1994 when Congress granted interstate branching powers to national banks for the first time, Congress provided equivalent branching privileges to FDIC-insured state banks. In 1999 Congress gave national banks and state banks comparable authority to expand their activities by establishing financial subsidiaries that may engage in nonbanking businesses not permitted for their parent banks.

2. Congress’s Preservation of the Dual Banking System Has Promoted Innovation and Flexibility in Banking Regulation

As shown in the preceding section, federal legislation since 1910 has established a dynamic interplay between competition and parity in the dual banking system. This dynamic allows significant room for diversity and rivalry between the national and state banking systems. At the same time, Congress has preserved an effective balance between the two systems. This interplay between competition and parity reflects a deliberate congressional purpose (i) to allow state laws to apply to national banks (either by express statutory mandate or by congressional silence) in many areas of the banking business and (ii) 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.

As the Supreme Court has recognized, the foregoing history shows that Congress has followed a “policy of equalization” designed to maintain a basic parity of competitive opportunities between national and state banks. In a 1964 district court decision later affirmed by

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129 See Scott, supra note 123, at 15–18, 37, 39–40.

130 Brown, supra note 110, at 58.

the Supreme Court, the district court discussed the apparent reasons for Congress’s decision to follow a policy of maintaining “competitive equality in at least the most important areas of competition” between national and state banks:

[1] In 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.

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.132

In the same year, 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 Franklin National Bank v. New York, a case frequently cited by the OCC (see, e.g., OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1910 n.53), the Supreme Court observed that “the Federal Government is a rival chartering authority for banks...[and that] these federal institutions may be at no disadvantage in competition with state-created institutions, the Federal Government has frequently expanded their functions and authority.” 347 U.S. 373, 375 (1954) (emphasis added). This statement is consistent with the Court’s recognition, in Walker Bank, 385 U.S. at 261, and Lewis, 292 U.S. at 564, that Congress has adopted a “policy of equalization” intended to maintain a basic parity of competitive opportunities within the dual banking system. Franklin certainly does not identify a congressional desire to give national banks a decisive competitive advantage over state banks and thereby threaten the viability of the state banking system. In fact, the Court acknowledged in Franklin that national banks are subject to state law whenever Congress expressly incorporates state-law standards in federal statutes, or, “[e]ven in the absence of such express language, national banks may be subject to some state laws in the normal course of business if there is no conflict with federal law.” 347 U.S. at 378 n.7.

in the other “powers and limitations” of national and state banks related to “investments, trust powers, and the like.”

At the same time, Senator Robertson pointed out that the dual banking system does not provide “identical” powers to national and state banks and permits “diversity and experimentation” within a balanced framework ensuring that “both parts of the system are strong and effective.” 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 Congress has subsequently incorporated many of the states’ successful innovations into federal legislation. In addition to the examples noted above of checking accounts, bank branches, real estate loans, trust services, and NOW accounts, the state banking system originated reserve requirements, deposit insurance, adjustable-rate mortgages, automated teller machines (“ATMs”), 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 bank regulators, the FRB, and the FDIC.

Supporters of the dual banking system argue that this record of innovation is the product of beneficial competition between federal and state regulators. For example, Kenneth Scott has suggested that federal and state bank regulators “can be viewed as firms producing different brands of regulation and engaged in a species of competition for market shares.” Regulatory competition for bank charters encourages regulators for both systems to be flexible, responsive, and

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133 A. Willis Robertson, Speech at the 62d Annual Convention of the National Association 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. 33, 36 (1966) [hereinafter 1966 Senate Hearings]; see also K.A. Randall, FDIC Chairman, Speech before the Texas Bankers Association (June 6, 1967), quoted in Brown, supra note 110, 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”).

134 1966 Senate Hearings, supra note 133, at 36–37.


136 Scott, supra note 123, at 32.
innovative. For example, during the 1960s Comptroller of the Currency James Saxon liberalized the OCC’s chartering policies and issued a number of rulings expanding the powers of national banks. Although several of Mr. Saxon’s rulings were struck down by federal courts, his initiatives prompted many state banks to convert to national charters. In turn, this conversion trend caused many states to modernize their state banking codes to improve the attractiveness of state charters.\footnote{See BROWN, supra note 110, at 33–38, 57–58; Scott, supra note 123, at 20–36; Wilmarth, Dual Banking System, supra note 49, at 1157–58.}

During the 1980s and early 1990s, the OCC’s success in obtaining court decisions expanding intrastate branching opportunities for national banks forced many states to adopt laws granting statewide branching privileges to state banks.\footnote{See Wilmarth, Dual Banking System, supra note 49, at 1158–59; Wilmarth, Too Big to Fail, supra note 49, at 963, 977.} During the same period, state initiatives allowing state banks to offer securities and insurance products encouraged federal regulators to take similar steps. These state and federal regulatory innovations helped persuade Congress to enact GLBA in 1999, which removed legal barriers separating the banking industry from the securities and insurance businesses.\footnote{Wilmarth, Dual Banking System, supra note 49, at 1161–69, 1177–81; See generally Broome & Markham, supra note 84, at 743–61; LITAN, supra note 110, at 50–58; 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, at 219–23, 318–20 [hereinafter Wilmarth, Transformation].} Thus, the regulatory competition for bank charters has placed continuing pressure on state officials and the OCC to demonstrate that they can provide innovative, responsive, and cost-effective supervision to their regulated constituents.\footnote{See, e.g., Rob Blackwell, State, Federal Regulators Fight Over Charter Flips, AM. BANKER, June 19, 2000, at 4; Kenneth Cline, Atlanta’s Bank South Applies for Conversion to a State Charter, AM. BANKER, June 22, 1995, at 4; Justin Fox, Stampede Toward State Charters Makes the OCC Change Its Tune, AM. BANKER, Aug. 28, 1995, at 3; Rhoads, supra note 135.}

By allowing banks to escape from arbitrary or outdated regulation, the dual banking system creates a “dynamic” rivalry between the national and state banking systems, a process that Professor Scott aptly described in the following terms:

[T]he dual banking system is a dynamic and interactive regulatory structure, so that a change in the content or effect of regulation in
one sector releases a series of forces. Banks reassess their profitability estimations, those at the margin may convert, and the agencies respond with further changes in regulatory content or policy. This process certainly is perceived, if not clearly articulated, by those involved with banks and their regulation, and is reflected in banking legislation.  

While the dual banking system has been attacked by prominent critics, public officials continue to defend the system’s merits. For

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141 Scott, supra note 123, at 34. For further discussion of the regulatory competition inherent in the dual banking system, see id. at 12–13, 20–36; BROWN, supra note 110, at 33–38, 57–66; Wilmarth, Dual Banking System, supra note 49, at 1155–59.

142 Critics have challenged the dual banking system on two principal grounds. First, former FRB chairman Arthur Burns, Geoffrey Miller, and others have maintained that (i) the dual chartering system tends to foster a “competition in laxity” between federal and state regulators and (ii) “moral hazard” may encourage regulators to neglect safety and soundness considerations in favor of building their regulated constituencies. Second, Henry Butler, Jonathan Macey, and others have argued that the expanding scope of federal statutory preemption negates any meaningful competition within the dual banking system. In response to these challenges, supporters of the dual banking system have argued that (i) bank failures injure the personal reputations of regulators and the perceived value of their charter “brand,” and regulators therefore have powerful incentives to uphold prudent safety and soundness standards; and (ii) while federal preemption presents a potentially fatal threat to the dual banking system, Congress has thus far given state regulators a substantial degree of freedom to compete with the OCC. For discussions of, and responses to, the foregoing criticisms of the dual banking system, see BROWN, supra note 110, at 38–41, 57–66; Scott, supra note 123, at 12–13, 33, 40–45; Richard M. Whiting, The New ‘Tri-Partite’ Banking System, 17 BANKING POL’Y REP. (Aspen) No. 7, at 13 (Apr. 6, 1998); Wilmarth, Dual Banking System, supra note 49, at 1239–55.

It is true that, since 1991, the ability of state banks to develop innovative products and services has been limited by 12 U.S.C. § 1831a. Under § 1831a, FDIC-insured state banks may not engage as principal (either directly or through a subsidiary) in any activity that is not permissible for national banks, unless the FDIC determines that the activity does not pose a significant risk to the deposit insurance fund. Thus, under § 1831a, the FDIC has a veto power over the ability of state banks to engage (except as agent) in activities that are not lawful for national banks.

It should be noted, however, that the FDIC has announced a policy of responding positively to proposals by state banks to commence new activities under § 1831a as long as such proposals do not present undue risks to safety and soundness. The FDIC’s policy under § 1831a is to permit state banks to “be innovative and stay competitive in a changing marketplace.” Don Powell, FDIC Chairman, Remarks Before the Annual Meeting of the Conference of State Bank Supervisors (May 30, 2002), available at http://www.fdic.gov/news/news/speeches/archives/2002/sp30may02.html. For a list of activities and investments that the FDIC has approved for state banks under § 1831a, see FDIC, Equity Investments Approved by the FDIC (Oct. 4, 2002), at http://www.fdic.gov/regulations/resources/approved/page1.html.
example, the 1984 report of the Presidential Task Group on Regulation of Financial Services hailed 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 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 . . . .

Because it has served the financial needs of the nation so well over time, state participation in the chartering and regulation of financial institutions can genuinely be regarded as one of the finest examples of cooperative federalism in the nation’s history. Because the balance of state and federal regulatory participation helps promote the public interest in a safe and competitive financial system, the dual system of chartering financial institutions should be maintained and strengthened wherever possible . . . .

. . . .

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. 143

In two recent speeches federal bank regulators have 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.” In May 2003 FRB Governor Susan S. Bies praised “the remarkable strength of the dual banking system,” and she further described the benefits that the dual banking system produced in comparison with the 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 . . . . 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.

My own research supports Governor Bies’s conclusions. In previous articles, I presented evidence showing that the dual banking system has fostered a decentralized, competitive, and innovative banking system comprised 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


145 Susan S. Bies, Federal Reserve Board Governor, Remarks Before the Conference of State Bank Supervisors (May 30, 2003), at http://www.federalreserve.gov/boarddocs/speeches/2003/20030530/default.htm; see also Whiting, supra note 142, at 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”).
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 financial markets.\(^{146}\)

Moreover, a recent study by FRB staff economists suggests that the dual banking system produces important macroeconomic benefits.\(^ {147}\) Based on banking and economic data from forty-nine nations, this study found that countries with stronger community bank sectors experienced faster growth in their gross domestic product, higher employment by SMEs, and increased availability of bank credit.\(^ {148}\) My own research indicates that (i) the dual banking system has provided a favorable regulatory environment that allows community banks to flourish in the United States and (ii) community banks have played an indispensable role in providing personalized services to consumers and longer-term relationship loans to SMEs.\(^ {149}\) In my view,


For recent reports indicating that the highly consolidated banking systems of Canada and the United Kingdom provide inferior service and charge excessive fees to smaller, bank-dependent firms, see Canadian Fed’n of Indep. Bus., Banking on Competition: Results of CFIB Banking Survey (Oct. 2003), at 3, available at http://www.cfib.ca/research/reports/Banking_report_2003.pdf (stating that “there is not a single Big Five bank that seems to be taking a leadership role in serving the [small and medium-sized enterprise (“SME”)] sector”); id. at 18 (stating that “the major banks have not yet demonstrated that they are able to serve the SME market,” and “[t]here is currently insufficient competition in the [Canadian] banking industry”); Patrick Tracey, UK Officials Order Bank Price Controls, Cite Poor Treatment of Small Businesses, 71 Banking Rep. (BNA) 499 (Mar. 18, 2002) (reporting that the U.K. government had imposed price controls on the “big four clearing banks” after a report concluded that those banks (i) controlled more than eighty-five percent of all small-business accounts, (ii) earned “excessive profits” from SMEs, and (iii) engaged in several practices that “restrict or distort competition and operate against the public interest”).


\(^{148}\) See id.

\(^{149}\) See Wilmarth, Dual Banking System, supra note 49, at 1152–57; Wilmarth, Too Big to Fail, supra note 49, at 961–64, 969–77, 1038–48; Arthur E. Wilmarth, Jr., Too Good to Be True? The Unfulfilled Promises Behind Big Bank Mergers, 2 STAN. J. L., BUS. & FIN. 1, 2–5, 12–14, 31–41; Wilmarth, Transformation, supra note 139,
the disappearance of a vibrant dual banking system would likely undermine the competitive health of our community banking system and impair the overall performance of our national economy.

In addition to preserving the state banking system, Congress has promoted competition and innovation in the U.S. banking industry by dividing bank supervisory responsibilities at the federal level among the FDIC, FRB, and OCC. This decentralized structure permits banks to select among three federal regulators, in addition to their choice between federal and state charters. By maintaining this structure, which promotes rivalry (and flexibility) among regulators, Congress has prevented the emergence of a single federal “super regulator” that could dominate the U.S. banking industry by agency fiat. Several commentators have concluded that this allocation of federal supervisory responsibility among three agencies helped to preserve the competitive dynamic that operates between federal and state regulators under the dual banking system.150

at 254–72, 293–99. The previously-cited FRB staff study noted “a significant amount of research” indicating that smaller, community-based banks enjoy important “advantages” over large banks in the area of “relationship lending to informationally opaque SMEs in developed nations.” Berger et al., supra note 147, § 1.1; see also Jeffrey W. Gunther & Robert R. Moore, Small Banks’ Competitors Loom Large, S.W. ECON. (Fed. Res. Bank of Dallas, TX), Jan./Feb. 2004, at 1, 11–12 (stating that banks with assets of less than $1 billion accounted for 37% of total bank lending to small businesses in 2003, despite holding only thirteen percent of the U.S. banking industry’s total assets; in addition, small banks devoted 19% of their assets to small business loans while banks larger than $25 billion devoted only 3.5% of their assets to such loans).

150 The OCC regulates all national banks, while the FRB regulates state banks that are members of the FRS and the FDIC supervises state nonmember banks. See, e.g., BROWN, supra note 110, at 18–22, 60–66; Scott, supra note 123, at 1–2, 6–9, 20–23, 30–36, 39–40, 43–48; Whiting, supra note 142; Wilmarth, Dual Banking System, supra note 49, at 1159–66, 1239–40; see also Richard J. Rosen, Is Three a Crowd? Competition Among Regulators in Banking, 35 J. MONEY, CREDIT & BANKING 969, 996 (2003) (finding that the allocation of supervisory responsibility among the FDIC, FRB, and OCC improves the performance of banks by allowing them to change their business strategies more easily, because each bank can switch to a regulator who is more willing (and better suited) to approve and monitor the bank’s chosen new strategy).

In contrast to the United States, the United Kingdom and Japan have each recently created a unified national agency with comprehensive authority to regulate all providers of financial services. For discussions of the potential advantages and pitfalls of such a “super regulator,” see, for example, Eilis Ferran, Examining the United Kingdom’s Experience in Adopting the Single Financial Regulator Model, 28 BROOK. J. INT’L L. 257, 277–307 (2003); Jerry W. Markham, Super Regulator: A Comparative Analysis of Securities and Derivatives Regulation in the United States, the United
3. Congress Has Endorsed the General Application of State Laws to National Banks as an Important Mechanism for Preserving the Dual Banking System

In accordance with its general policy of maintaining a competitive balance in the dual banking system, Congress has deferred to state law in two ways. First, Congress expressly incorporated state-law standards into several federal statutes, thereby establishing state law as the governing rule for national banks in a number of important areas. Subsequent to McClellan, the Supreme Court declared:

[T]he purpose and object of Congress in enacting the national bank law was to leave [national] banks as to their contracts in general under the operation of the state law, and thereby invest them as Federal agencies with local strength, whilst, at the same time, preserving them from undue state interference wherever Congress within the limits of its constitutional authority has expressly so directed, or wherever such state interference frustrates the lawful purpose of Congress or impairs the efficiency of the [national] banks to discharge the duties imposed upon them by the law of the United States.

In Atherton, decided a century after McClellan, the Supreme Court observed that Congress never overruled the Court’s view that “federally chartered banks are subject to state law.” Similarly, in National Kingdom, and Japan, 28 Brook. J. Int’l. L. 319, 377–96, 405–10 (2003); Heidi M. Schooner & Michael Taylor, United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets, 38 Tex. Int’l. L.J. 317, 331–44 (2003).

For example, Congress has expressly incorporated state law as the governing standard (in whole or in part) for the following transactions involving national banks: conversions of state banks into national banks, 12 U.S.C. § 35 (2000); intrastate branching, id. § 36(c); interstate de novo branching, id. § 36(g); accepting deposits from state and local governments, id. § 90; fiduciary activities, id. § 92a; conversions of national banks into state banks, or mergers or consolidations between national banks and state banks in which the surviving banks will have state charters, id. § 214c; acquisitions of state banks by consolidation, id. § 215(d); and acquisitions of state banks by merger, id. § 215a(d). See Scott, supra note 123, at 37.


Atherton v. FDIC, 519 U.S. 213, 222 (1997); see also Scott, supra note 123, at 16–17 (stating that “Congress has said nothing explicit . . . about most operations of national banks,” and “courts have created only limited federal governing rules,
State Bank v. Long\textsuperscript{154} the Third Circuit noted that Congress followed a general policy of \textit{supporting} the application of state laws to national banks:

Whatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863. . . . There is little doubt that in the exercise of its commerce power Congress could regulate national banks to the exclusion of state control. And unquestionably, as in other businesses, federal presence in the banking field has grown in recent times. But congressional support remains for dual regulation. In only a few instances has Congress explicitly preempted state regulation of national banks. More commonly, it has been left to the courts to delineate the proper boundaries of state and federal supervision.\textsuperscript{155}

Quoting \textit{McClellan} and \textit{Luckett}, the Third Circuit pointed out in Long that the “judicial test [for preemption] has been a tolerant one.”\textsuperscript{156} Based on this “tolerant” standard, the Third Circuit held that national banks must comply with a New Jersey statute, which prohibited all banks from engaging in geographic discrimination in their home mortgage lending (“redlining”).\textsuperscript{157} The court noted that Congress passed three statutes—the Home Mortgage Disclosure Act, the Community Reinvestment Act, and the Equal Credit Opportunity Act—designed to encourage fair lending by banks, and the court observed that those statutes “[do] not expressly prohibit redlining.”\textsuperscript{158} In addition, the court found that Congress had not granted to the states leaving most banking operations to be controlled by state law”); Testimony of Reed H. Albig, Chairman, Fed. Legislative Comm., Indep. Bankers Ass’n of America, May 18, 1966, in 1966 Senate Hearings, supra note 133, at 157, 161 (explaining that Congress and the courts have supported the general application of state law to national banks in order “to achieve competitive equality between National and State banks competing in the same State. This delicate accommodation is necessary to prevent banks in one system from overwhelming banks in the other system”).

\textsuperscript{154} 630 F.2d 981 (3d Cir. 1980).


\textsuperscript{156} Long, 630 F.2d at 985–86.

\textsuperscript{157} Id. at 982, 986–87.

\textsuperscript{158} Id. at 984.
any *express* authority to enact anti-redlining legislation.\textsuperscript{159} Nevertheless, the court rejected a preemption claim raised by two national banks, and the court held that national banks must adhere to New Jersey’s anti-redlining law.\textsuperscript{160} In doing so, the court declared: “[W]e reject the plaintiffs’ argument that once Congress legislates on a matter in the banking field, specific authorization must be given before supplementary state laws may take effect.”\textsuperscript{161} Three subsequent court decisions similarly held that federal banking laws do not preempt the states from requiring all banks, *including* national banks, to refrain from imposing unreasonable, unconscionable, or bad faith service charges on their customers.\textsuperscript{162}

Congress strongly reaffirmed its support for the general application of state laws to national banks when it passed the Riegle-Neal Act in 1994.\textsuperscript{163} The conference report on the 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 application of state laws to national banks is 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.

\textsuperscript{159} Id. at 988.

\textsuperscript{160} Id. at 982.

\textsuperscript{161} Id. at 987.


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.164

The Riegle-Neal Act requires interstate branches of national banks to comply with nondiscriminatory host state laws in four broadly defined areas (viz., community reinvestment, consumer protection, fair lending, and intrastate branching) except in situations where federal law preempts the application of such laws to national banks.165 Members of Congress emphasized that this mandate for compliance with host state laws was an important component of the Riegle-Neal Act’s general purpose of maintaining the vitality of the dual banking system.166

The Riegle-Neal Act also requires each federal banking agency to comply with notice-and-comment requirements whenever it intends

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166 See, e.g., 140 CONG. REC. H6775 (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 H6777 (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 H6780 (remarks of Rep. Castle, declaring that “[w]e have indeed protected the duel [sic] banking system which is so important to the United States”); id. at H6781 (remarks of Rep. Vento, stating that the Riegle-Neal Act “maintains a positive role for the States” and “applies State consumer protection, fair lending, intrastate branching, and community reinvestment laws to branches of out-of-State banks, unless pre-empted or upon a determination of discriminatory effect by the [OCC]”); id. at H6782 (remarks of Rep. LaFalce, explaining that “[t]his legislation fully recognizes the crucial role States play in regulating financial institutions within their borders and particularly in protecting their consumers”); id. at S12,784 (daily ed. Sept. 13, 1994) (remarks of Sen. Ford, explaining that the Riegle-Neal Act “has been carefully structured in a manner which protects important States’ rights under our dual banking system”); id. at S12,784 (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”).
to issue an opinion letter or interpretive rule that would preempt the application to national banks of state laws affecting one or more of the designated four areas.\footnote{Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 § 114, 108 Stat. 2366 (codified at 12 U.S.C. § 43(a)) (requiring a federal banking agency to publish a notice in the Federal Register and solicit comments from the public whenever the agency intends to issue an opinion letter or interpretive rule that would preempt a state law dealing with community reinvestment, consumer protection, fair lending, or intrastate branching).} The House-Senate conferees on the Riegle-Neal Act instructed the federal agencies that they should not issue rulings that preempt state laws in the four designated areas unless “the legal basis is compelling and the Federal policy interest is clear.”\footnote{H.R. Rep. No. 103-651, at 55 (Conf. Rep.) (1994), reprinted in 1994 U.S.C.C.A.N. at 2076; see also id. at 53, reprinted in 1994 U.S.C.C.A.N. at 2074 (containing a similar admonition).} The conferees specifically criticized two OCC interpretive rulings asserting that state laws did not apply to the deposit-taking activities of national banks. The conferees declared that those OCC rulings were “inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result.”\footnote{Id. at 53–54, reprinted in 1994 U.S.C.C.A.N. at 2074–75 (criticizing (i) OCC Interpretive Letter No. 572, which stated that national banks could disregard a New Jersey statute requiring all banks to offer lifeline checking accounts, and (ii) 12 C.F.R. § 7.8000, which declared that all state laws regulating service charges on deposit accounts were inapplicable to national banks).} In response to the conferees’ criticism, as discussed below, the OCC rescinded an interpretive rule that purported to preempt all state laws affecting the ability of national banks to impose service charges on their depositors.\footnote{Mr. Cayne and Ms. Perkins suggest that, by discussing the new requirements for issuing agency preemption determinations under 12 U.S.C. § 43(a), House Report 651 “underscored the OCC’s authority to make preemption decisions.” Cayne & Perkins, supra note 2, at 396. This suggestion, however, fails to account for the very significant fact that the Riegle-Neal conferees rejected both of the OCC’s preemption rulings that were addressed in the conference report. As a consequence, the conference report must be viewed as a repudiation of the OCC’s preemption theories contained in those rulings.}

Consistent with Congress’s policy of supporting the general application of state laws to national banks, most courts until recently applied a presumption in favor of applying state laws to the activities of national banks. Based on this presumption, the courts required national banks to comply with state laws \textit{unless} preemption was consistent with

\footnote{See infra notes 370–76 and accompanying text (discussing the OCC’s rescission of § 7.8000 in 1996).}
“the clear and manifest purpose of Congress.” Similarly, in two cases the Supreme Court declared the general application of state laws to the activities of national banks is “the rule,” while preemption is “the exception”:

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\text{
\textit{The rule} is the operation of general state laws upon the dealings and contracts of national banks, [while] \textit{the exception} is the cessation of 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 laws of the United States.}
\]

In 1995 the OCC issued an interpretive letter that was consistent with this judicial presumption, as well as the views expressed in 1994 by the House-Senate conferees on the Riegle-Neal Act. In OCC Interpretive Letter Number 674 (“OCC IL 674”) OCC Chief Counsel Julie Williams determined that the NBA did not preempt a Texas statute and a rule regulating the naming of bank branches and the use of branch names in advertising. The Texas provisions barred bank branches located in Texas from using any branch name or branch advertising that tended to portray the branch as a separately chartered bank. This prohibition was designed to prevent deceptive advertising that might lead customers to view a branch office as a separate bank which could offer additional federal deposit insurance coverage. The OCC Chief Counsel concluded that Texas had authority to protect consumers by prohibiting all banks, including national


174 Id. at **12–13.

175 Id. at *14.

176 See id.
banks, from using deceptive marketing techniques.\textsuperscript{177} In addition, based on several of the court decisions reviewed above, the OCC Chief Counsel agreed that the following general principles governed the application of state laws to national banks. First, “[u]nder the dual banking system, all banks, including national banks, are subject to the laws of the state in which they are located unless those state laws are preempted by federal law or regulation.”\textsuperscript{178} Second:

Banking is the subject of comprehensive regulation at both the federal and state level and the valid exercise of concurrent powers is the general rule unless the state law is preempted. State law applicable to national banks will generally be presumed valid unless it conflicts with federal law, frustrates the purpose for which national banks were created, or impairs their efficiency to discharge the duties imposed upon them by federal law.\textsuperscript{179}

In concluding that the NBA did not preempt the Texas provisions, OCC IL 674 determined that the Texas statute and rule did not conflict with any federal statute, were not “unduly burdensome” to national banks, and did not “impair[] their ability to discharge the duties imposed by federal law.”\textsuperscript{180} Thus, OCC IL 674 indicated that the OCC agreed with the judicially-created and congressionally-recognized preemption standards discussed above, including the presumption in favor of applying state laws to national banks.\textsuperscript{181}

\section*{4. Congress Has Withheld From the OCC Any Independent Power to Preempt State Laws}

In addition to its general policy of allowing state laws to apply to national banks, Congress has withheld from the OCC any independent power to override state laws. Under § 93a\textsuperscript{182} the OCC has authority to issue regulations “to carry out the responsibilities of the office.”\textsuperscript{183}

\begin{itemize}
  \item \textsuperscript{177} Id. at **12–13. The OCC’s Chief Counsel noted that the Texas statute and rule treated all banks equally. Given those circumstances, she stated: “The national banking laws do not prevent state measures aimed at preventing misleading advertising, as long as the state regulations do not put national banks at a competitive disadvantage relative to state financial institutions.” Id. at *13.
  \item \textsuperscript{178} Id. at *8 (emphasis added) (citing Waite, Davis, and Luckett).
  \item \textsuperscript{179} Id. at **8–9 (emphasis added) (citing Long).
  \item \textsuperscript{180} Id. at *12.
  \item \textsuperscript{181} Id.
  \item \textsuperscript{182} 12 U.S.C. § 93a (2000).
  \item \textsuperscript{183} Id.
\end{itemize}
However, as indicated by its limited terms, § 93a does not authorize the OCC to expand the statutory powers or immunities of national banks by preempting state law.\textsuperscript{184} When § 93a was enacted in 1980, Congress made clear that the OCC’s rulemaking authority thereunder:

is only available to carry out the responsibilities of the [OCC] and carries with it no new authority to confer on national banks powers which they do not have under existing substantive law. To give national banks authority under this rulemaking provision that they do not possess under existing substantive law would not be carrying out the responsibilities of the [OCC] since only Congress can define those responsibilities so as to confer powers on national banks.\textsuperscript{185}

After reviewing the terms and legislative history of § 93a, a federal appeals court held in 1983 that (i) § 93a “grants no new substantive powers to banks” and (ii) § 93a does not allow the OCC to preempt state laws by “authoriz[ing] activities that run afoul of federal laws governing the activities of national banks.”\textsuperscript{186}

Until recently the OCC apparently understood that § 93a does not permit the OCC to expand, by unilateral, preemptive action, the congressionally-authorized powers or immunities of national banks.\textsuperscript{187} In his speech of February 12, 2002, Comptroller Hawke acknowledged that “the OCC has no self-executing power to preempt state law.”\textsuperscript{188} Comptroller Hawke noted that the OCC “has on many occasions expressed opinions about the preemptive effect of federal law.”\textsuperscript{189} However, the narrow scope of the OCC’s rulemaking power under § 93a makes clear that the OCC’s “opinions” do not carry any independent preemptive force.\textsuperscript{190}

\textsuperscript{184} Id.


\textsuperscript{186} Conference of State Bank Supervisors v. Conover, 710 F.2d 878, 885 (D.C. Cir. 1983) (emphasis in original).


\textsuperscript{188} Id.

\textsuperscript{189} Id. (emphasis added).

\textsuperscript{190} See 12 U.S.C. § 93a.
C. The OCC’s Rules Threaten to Destroy the Dual Banking System

1. The OCC’s Rules Are Designed to Convince Large, Multistate Banks to Operate under National Charters

Notwithstanding the OCC’s apparent understanding of judicial precedents and congressional policy in 1995 when it issued OCC IL 674, the OCC’s new rules create a regime of de facto field preemption for national banks.191 Under this new regime, state laws may only “provide a framework for a national bank’s ability to exercise powers granted under Federal law; they [may] not obstruct or condition a national bank’s exercise of those powers.”192 In other words, state laws apply only if they are helpful to national banks; all state laws placing limitations or “conditions” on the business of national banks are preempted.

In his speech of February 12, 2002, Comptroller Hawke revealed the policy considerations that have evidently caused the OCC to change its view of preemption since 1995.193 In that speech Mr. Hawke declared that “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.”194 He further claimed 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.”195 Similarly, when the OCC proposed its preemption rules, the OCC declared its desire to promote “a ‘complete’ national banking system, free from state control, and subject to uniform, national standards.”196

191 See supra Part II; supra notes 173–81 and accompanying text (discussing OCC IL 674).

192 OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1895; see also OCC Docket, supra note 1, 69 Fed. Reg. at 1912 (declaring that non-preempted state laws “typically 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”).


194 Id.

195 Id.

196 OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,129. Mr. Cayne and Ms. Perkins suggest that my description of the OCC’s regulations reflects “a fundamental misunderstanding of the actual nature of the OCC’s new rules.” Cayne & Perkins,
In short, the OCC evidently concluded that an aggressive preemption campaign—promising freedom from state regulation—is a “significant benefit” and “major advantage” that will persuade large, multistate banks to operate under national charters. In a newspaper article published in early 2002, two reporters described Mr. Hawke’s views on preemption 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.’”

The same article noted that AmSouth, a large state-chartered bank headquartered in Birmingham, Alabama, rejected Mr. Hawke’s personal appeal to convert to a national charter when AmSouth acquired a Tennessee national bank in 1999. Mr. Hawke also reportedly said that “the potential loss of regulatory market share [to the state banking system] ‘was a matter of concern to us.’” This newspaper account provides further evidence of the competition between federal and state regulators for bank charters that has long characterized the dual

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197 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, Apr. 9, 2003, at 1 [hereinafter Davenport, OCC and Georgia Law] (quoting Ronald Glanz); see also Cantor, supra note 26 (quoting another prominent Washington attorney, Gilbert Schwartz, who suggested 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).


199 Id. (quoting Mr. Hawke).
banking system.\textsuperscript{200} However, instead of pursuing the traditional regulatory strategies of innovation, responsiveness, and cost efficiency, the OCC has evidently chosen preemption by agency fiat as its primary competitive weapon against the state banking system.

Many of the largest national banks supported the OCC’s preemption rules, and the OCC’s preemption initiatives are widely viewed by commentators as serving the interests of big, multistate national banks.\textsuperscript{201} 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 fee assessments to the OCC.\textsuperscript{202} By proposing 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

\begin{footnotesize}
\textsuperscript{200} See discussion supra Part III.B.

\textsuperscript{201} See Todd Davenport, Are States, OCC Near a Preemption Showdown?, \textit{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); Sapsford, supra note 26, at C1 (stating that the OCC’s preemption of the GFLA, discussed supra note 27, “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”); see also New York Attorney General Eliot Spitzer, Whose Side are They On? The Federal Government’s Effort to Curtail State Enforcement of Predatory Lending and Other Consumer Protection Laws, Lecture Delivered at Georgetown University 7 (Feb. 24, 2004) [hereinafter 2004 Georgetown Lecture by Spitzer], \textit{available at} http://www.oag.state.ny.us/press/statements/georgetown_university.html (stating that “when the [national] banks ran to the OCC for protection from state predatory lending laws, they found a regulator that already was embarked on a mission to preempt nearly all state consumer protection laws and provide immunity from state attorneys general for the banks they regulate”).

\textsuperscript{202} In 2002, annual fee assessments and fees for corporate applications paid by national banks covered nearly ninety-seven percent of the OCC’s annual budget of $413 million. See Speech by Comptroller Hawke on Oct. 14, 2002, supra note 144, at 6. In the same year, the largest national bank, 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 197. 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) (2003); see also Blackwell, supra note 140 (stating that “[w]hether a bank company adopts a state or national charter makes a big difference to the regulators, because their budgets are linked to exam fees”).
\end{footnotesize}
application of state laws, except for those helpful state laws that “support[] the ability of national banks... to do business.”\textsuperscript{203}

As the Supreme Court observed in \textit{Walker Bank}\textsuperscript{204} in response to a similar OCC effort to evade state law, “[i]t is a strange argument that permits one to pick and choose what portion of the law binds him.”\textsuperscript{205} The OCC’s attempt to provide national banks with a blanket

\textsuperscript{203} OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1896; see R. Christian Bruce, \textit{Outlook 2004: Bank Regulation}, 82 Banking Rep. (BNA) 172, 175 (2004) (citing the prediction of Oliver Ireland, a prominent Washington, D.C. attorney, that “the [OCC]’s preemption rules will add to the attraction of the national bank charter,” and “[t]here won’t be as much interest in federal savings banks and federal thrifts, because now [national banks] have the same amount of preemption”).

The OCC’s current preemption campaign is, in part, a reaction to the OCC’s failure to win its earlier battle with the FRB over the question of which agency should control the permissible range of bank powers. During the 1990s the OCC argued that national banks should be allowed to engage in securities, insurance, and other nontraditional activities through direct subsidiaries, supervised by the OCC. In response, the FRB contended that banking organizations should be required to conduct nontraditional activities through holding company subsidiaries regulated by the FRB. In enacting GLBA, Congress largely sided with the FRB. GLBA permits financial subsidiaries of national banks to engage in activities that the FRB has determined to be financial in nature for financial holding companies or incidental to such financial activities. However, financial subsidiaries of national banks may not engage in (i) insurance and annuities underwriting, (ii) insurance company portfolio investments, (iii) merchant banking (until 2004, at the earliest, and then only with the joint approval of the FRB and the Treasury Secretary), and (iv) real estate development and investment. In addition, the FRB has the right to veto any attempt by the Treasury Secretary to expand the list of activities permissible for financial subsidiaries of national banks. To add insult to injury, Congress gave FDIC-insured state banks an equivalent (and perhaps even more favorable) authority to conduct nontraditional activities through direct subsidiaries. Thus, the OCC failed in its attempt to gain a major competitive edge for national banks by obtaining sole authority to approve broader powers for their direct subsidiaries. See GLBA, §§ 121(a), (d), 122, 113 Stat. 1373, 1380, 1381 (1999) (codified at 12 U.S.C. §§ 24a, 1831w, 1843 note (2000)); \textsc{Jonathan R. Macey et al., Banking Law and Regulation} 495–507 (3d ed. 2001); \textsc{Patricia A. McCoy, Banking Law Manual} § 4.02 at 4-9, 4-16, 4-17 (2d ed. 2003); \textit{id.} § 4.06 at 4-65, 4-66, 4-70 through 4-78. That defeat impelled the OCC to redouble its preemption efforts so that it could create a different type of competitive advantage for national banks over their state-chartered rivals.


\textsuperscript{205} \textit{id.} at 261. In \textit{Walker Bank}, the OCC argued that 12 U.S.C. § 36(c) permitted national banks to establish branches by every method as long as the relevant state allowed its banks to establish branches by at least one method. Thus, the OCC claimed that it could permit a Utah national bank to establish new branches even though Utah limited branching and allowed its state banks to open branches only by acquiring existing banks. The Supreme Court held that the OCC’s “pick and choose” theory violated the terms of § 36(c) as well as the congressional policy of “competitive equality” incorporated therein. \textit{id.} at 253–55, 259–62.
exemption from state laws—except for laws the OCC likes—is plainly inconsistent with the congressional policy of maintaining a competitive balance in the dual banking system, which the Supreme Court identified in *Walker Bank* and *Lewis*.206 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 Congress has not established an explicit federal standard to govern the business conducted by national banks, the Third Circuit concluded:

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.207

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 conversions by banks belonging to the other system.208

The OCC’s preemption rules pose a serious threat to the state banking system. 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.209

206 See supra note 131 and accompanying text (discussing the Supreme Court’s reference in *Walker Bank* and *Lewis* to the congressional “policy of equalization” underlying the dual banking system). Mr. Cayne and Ms. Perkins accuse me of being “specious” in contending that the OCC’s rules create a “blanket exemption from state laws” for national banks. Cayne & Perkins, supra note 2, at 373. However, they overlook my important qualifier, stated above—viz., “except for laws the OCC likes.” As demonstrated elsewhere, the OCC’s rules permit state laws to apply to national banks only if the OCC determines that such laws are “incidental” in the sense of *promoting* and being favorable to the ability of national banks to conduct their business. See supra notes 20–22, 31–32, 192, 203, infra notes 281–82, 360–62, and accompanying text.


209 See Gee Remarks, supra note 135, at 4 (reporting that, as of June 30, 2003, 44 of the nation’s largest 100 banks, and fifty-six percent of all U.S. banks with interstate branches, held state charters).
either Congress or the courts, larger state-chartered banks will have strong incentives to convert to national charters so that they can match the ability of multistate national banks to operate without regard to restrictive state laws.\textsuperscript{210} I believe that, within the relatively near future, the OCC’s preemption rules are likely to induce most of the larger state-chartered banks with interstate branches to migrate to the national banking system.

Assuming that the OCC’s new preemption regime reduces the membership of the state banking system to a group composed primarily of smaller community-oriented banks, it will be very difficult for state banking departments to attract and retain highly-qualified supervisory personnel and to finance the administrative costs of bank oversight. Under the same assumption, the U.S. banking system will no longer have any meaningful duality because virtually all large banks will hold national charters and most small banks will hold state charters. Given those circumstances, 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. In addition, the remaining state regulators would no longer be able to function as significant laboratories for innovation by larger banks. Thus, most of the current benefits of the dual banking system described in Part III.B.2 are jeopardized by the OCC’s preemption rules.\textsuperscript{211}

\textsuperscript{210} Under 12 U.S.C. § 1831a(j), host state laws do not apply to local branches of an out-of-state state bank if such laws are inapplicable to national banks. Thus, under § 1831a(j), multistate state-chartered banks can invoke the OCC’s preemption rules to obtain immunity from host state laws, but only with respect to business conducted at their out-of-state branches. Section 1831a(j) does not immunize multistate state-chartered banks from the application of either home state laws or host state laws with respect to activities conducted by their home state branches, their non-branch offices, and their subsidiaries. In contrast, as described supra in Part II, the OCC’s preemption rules purport to override all restrictive state laws with respect to all offices and operating subsidiaries of national banks.

\textsuperscript{211} See, e.g., Wilmarth, Too Big to Fail, supra note 49, at 1071–72. In commenting on a preliminary draft of this article, Heidi Schooner pointed out that state officials could respond to the OCC’s preemption rules by granting equivalent immunities to state banks under state parity statutes. A recent survey found that forty-eight states have adopted laws allowing state banks to exercise powers granted to national banks under federal law. In forty-three of those states, parity laws permit state banks to engage in federally-authorized activities even if such activities are affirmatively prohibited by state law. In forty states, however, state bank regulators must give their approval (or withhold their disapproval) before state banks can exercise a federally-authorized power based on a parity statute. See John J. Schroeder, “Dual” Banking
2. The OTS’s Adoption of Similar Preemption Rules Destroyed the Significance of the State-Chartered Thrift System

My pessimistic predictions about the likely impact of the OCC’s new regime are supported by a review of the contrasting trajectories 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 industries. 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. 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. In sharp 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 associations.


Thus, state bank regulators might attempt to retain the loyalty of state banks by using parity statutes to give them immunities from state law that are comparable to the preemption regime created by the OCC’s new rules. However, such an attempt would not succeed unless virtually all state regulators agreed to cooperate in establishing a uniform nationwide immunity scheme that is as “seamless” as the OCC’s preemption regime. In addition, the creation of a nationwide scheme based on state parity laws could itself lead to the “demise of the dual banking system.” Id. at 221. As explained in Part III.B.1, a principal justification for the dual banking system is the record of innovation that has been produced by differences in regulatory approaches among state and federal officials. Accordingly, “[t]he more the state regulators and state banking codes become homogenized [and similar to federal banking regulation], the less justification there is for the continuation of the dual banking system.” Id. In sum, the OCC’s preemption rules present a formidable threat to the dual banking system however the states choose to respond.

212 See Scott, supra note 123, at 3 nn.11–13, 4 nn.15–16.

213 See Gee Remarks, supra note 135, at 3. Of the 445 new banks that were organized between January 1, 2000, and June 30, 2003, 345 (or seventy-eight percent) were chartered as state banks. Id. at 4; see also FDIC, Summary of Deposits, National Totals by Charter Class as of June 30, 2003, at http://www2.fdic.gov/sod/sodSumReport.asp?barItem=3&sInfoAsOf=2003 [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).

214 See FDIC Summary of Deposits, supra note 213 (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).
What accounts for the drastic shrinkage of the state-chartered thrift industry from 1975 to 2003, compared with the successful performance of the state-chartered banking system during the same period? Some observers might point to the thrift debacle that occurred during 1980–1994. However, statistics for thrift failures during that period do not indicate any strong linkage between the thrift disaster and the severe decline in the relative position of state-chartered savings associations compared to federally-chartered thrifts. Between 1980 and 1994 federally-chartered savings associations accounted for a substantial majority of all thrift failures, measured in terms of both number of charters and total assets held by failed institutions in the federal and state systems. By comparison, during the same period federally-chartered banks accounted for slightly less than half of the charters, but a substantial majority of the assets, held by all failed banks. Thus, in the thrift and banking industries, federally-chartered institutions experienced a mortality rate roughly proportionate to their share of each industry’s charters and assets at the end of 1975. In other words, federally-chartered institutions in each industry appeared to suffer at least as much as state-chartered institutions from the financial crises of 1980–1994. Based on these statistics, the thrift debacle does not appear to explain the virtual disappearance of the state-chartered thrift system.

It might also be argued that the OTS gained a degree of supervisory authority over state savings associations in 1989; this authority may have encouraged state savings associations to convert to federal charters in order to reduce the regulatory duplication created by

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215 See FDIC, Managing the Crisis: The FDIC and RTC Experience, 1980–1994, at 830–31 (1998) (Chart C.39) (showing that (i) of the 1,295 savings associations that failed during 1980–1994, 747 (or 57.5%) were federally-chartered thrifts and (ii) of the $621 billion of assets held by savings associations that failed during the same period, $339.6 billion (or 54.7%) belonged to federally-chartered thrifts).

216 Id. at 829 (Chart C.38) (showing that (i) of the 1,617 banks that failed during 1980–1994, 741 (or 45.8%) banks held federal charters from the OCC or the OTS and (ii) of the $302.6 billion of assets held by banks that failed during the same period, $176.5 billion (or 58.3%) belonged to banks that held federal charters from the OCC or OTS).

217 Federally-chartered savings associations held half of all savings association charters and sixty percent of all thrift assets at the end of 1975, while accounting for fifty-seven percent of the thrift failures and fifty-five percent of total failed thrift assets during 1980–1994. Federally-chartered banks held about one-third of all bank charters and fifty-eight percent of all bank assets at the end of 1975, while accounting for forty-six percent of all bank failures and fifty-eight percent of total failed bank assets during 1980–1994. See supra notes 212–16 and accompanying text.
combined federal and state oversight. However, the OTS shares supervisory responsibility for state savings associations with the FDIC, and the FDIC (or the FRB, in the case of state banks that are FRS members) exercises comparable safety-and-soundness authority over state banks.\textsuperscript{218} In addition, the OTS’s current supervisory powers over state savings associations are similar to the authorities that were exercised prior to 1989 by the Federal Savings and Loan Insurance Corporation, a sub-agency of the former Federal Home Loan Bank Board (“FHLBB”).\textsuperscript{219} Accordingly, it is difficult to identify any dramatic change in regulatory structure that would account for the disappearance of most state savings associations, particularly in light of the continued viability of state banks also subject to dual state and federal oversight.

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 1970s and the OTS continued after assuming the FHLBB’s functions in 1989. For example, in 1982 the Supreme Court upheld a regulation adopted by the FHLBB in 1976 that preempted all state laws restricting the ability of federal savings associations to include due-on-sale clauses in their mortgages.\textsuperscript{220} The Supreme Court concluded that, under the Home Owners’ Loan Act of 1933 (“HOLA”),\textsuperscript{221} “Congress invested the [FHLBB] with broad authority to regulate federal savings and loans so as to effect [HOLA’s]

\textsuperscript{218}See, e.g., H.R. Rep. No. 101-54(I), at 426–27 (1989), reprinted in 1989 U.S.C.C.A.N. 86, 222–23. While Congress in 1989 did not find it “practical for the structure of savings association regulation to mirror the structure of bank regulation,” Congress did use “the commercial bank regulatory structure [as] a useful model in its deliberations.” Id. at 426, reprinted in 1989 U.S.C.C.A.N. at 222. In addition to the similarity in regulatory structures for state banks and state savings associations, the federal restrictions on their permissible activities are also comparable. An FDIC-insured state bank may not engage as principal in any activity that is not permissible for national banks, and an FDIC-insured state savings association may not engage as principal in any activity that is not permissible for federally-chartered thrifts, unless the FDIC determines that the activity in question would not present a significant risk to the appropriate deposit insurance fund. See 12 U.S.C. §§ 1831a(a)(1), 1831e(a)(2000).


purposes, and plainly indicated that the [FHLBB] need not feel bound by existing state law.”

222 The Court expressly declined to consider whether HOLA empowered the FHLBB to preempt the application of all state laws to federal savings associations. However, the Court’s expansive description of the FHLBB’s authority under HOLA undoubtedly encouraged the FHLBB (and its successor, the OTS) to pursue an aggressive preemption agenda.

223 Also in 1982, a federal district court upheld another FHLBB regulation, which permitted federal savings associations to establish interstate branches without regard to state law by acquiring failed or failing thrifts in other states. A decade later the same district court rejected a challenge to an OTS rule, which abolished all geographic restrictions on branching by federal savings associations and thereby made it possible for such institutions to establish nationwide branching networks.

224 In 1983 the FHLBB issued § 545.2 of its regulations. As presently in force, § 545.2 asserts that the OTS has “plenary and


227 12 C.F.R. § 545.2 (2003); see Matthew M. Neumeier & Danielle J. Szukala,
exclusive authority . . . to regulate all aspects of the operations of Federal savings associations,” and that the OTS’s regulations are “preemptive of any state law purporting to address the subject of the operations of a Federal savings association.” In 1996 the OTS adopted regulations governing the lending powers of federal savings associations. Section 560.2 of those regulations declares that the “OTS hereby occupies the entire field of lending regulation for federal savings associations.”

In the following year the OTS adopted similar rules governing the deposit-taking activities of federal savings associations. Section 557.11(b) of those regulations proclaims that the “OTS hereby occupies the entire field of federal savings associations deposit-related regulations.”

As described in Part II, the substantive scope of preemption asserted in the OCC’s new preemption rules is essentially the same as the breadth of preemption declared in the OTS’s regulations.

Since the Supreme Court left the issue undecided in de la Cuesta, lower federal courts and state courts have divided on the question of whether HOLA and the agency regulations adopted thereunder create a comprehensive field preemption regime barring all state regulation of the activities of federal savings associations. However, the courts


12 C.F.R. § 545.2.

Id. § 560.2(a). For the OTS’s notice of final rulemaking that promulgated its lending regulations, see 61 Fed. Reg. 50,951 (Sept. 30, 1996) (codified at 12 C.F.R. §§ 545, 556, 560, 563, 566, 571, 590).


See supra notes 26–29 and accompanying text (comparing the OCC’s rules with the OTS’s regulations).

have generally agreed that §§ 545.2, 557.11, and 560.2 of the OTS’s rules are valid and preempt the states from regulating matters directly related to the deposit-taking and lending activities of federal savings associations. Like the OCC’s new rules, the OTS’s regulations assert a broad scope of preemption by declaring that state laws of general applicability, such as contract and tort laws, are preempted if such laws have more than an “incidental” effect on the deposit-taking or lending activities of federal savings associations. Some courts have agreed with the OTS’s position and, therefore, have preempted state contract and tort laws that had more than the permitted “incidental” effect on the operations of federal savings associations. In contrast, two courts recently held that the OTS’s regulations do not preempt state law obligations voluntarily assumed by a federal savings association under the terms of a contract.

While the outer boundaries of the OTS’s preemption authority are still being debated, there appears to be a general consensus that the OTS’s regulations create a regime of selective field preemption that precludes the states from regulating federal savings associations in the following three areas: (i) the establishment of branch offices or other

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234 See 12 C.F.R. §§ 557.13, 560.2(c) (2003); OTS Op. Chief Counsel, Mar. 10, 1999, reprinted in [1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-301 (declaring that California statutes prohibiting unfair business practices and deceptive advertising were preempted to the extent that courts were applying those statutes to restrict the ability of federal savings associations to advertise their services, to engage in “forced placement” of hazard insurance to protect borrowers’ collateral, and to assess loan-related fees).

235 See, e.g., Haehl, 277 F. Supp. 2d at 942–43 (concluding that tort law claims were preempted); Moskowitz, 768 N.E.2d at 264–66 (holding that contract and tort law claims were preempted).

facilities, (ii) lending activities, and (iii) deposit-taking activities. Without question, the OTS’s regulations have a broad preemptive impact because geographic expansion, lending, and deposit-taking are matters of primary concern for virtually all depository institutions. The OTS has aggressively asserted its preemption authority in these areas. For example, in 2003 the OTS issued preemption opinions declaring that federally-chartered thrifts were exempt from predatory lending laws enacted by Georgia, New York, New Jersey, and New Mexico.

Commentators have cited the OTS’s grant of unrestricted nationwide branching privileges and the OTS’s aggressive preemption of state laws as major advantages that federal thrifts enjoyed over national and state banks during the past several years. In early 2004 J.P. Morgan Chase (“Chase”), the largest state-chartered bank in the nation, obtained regulatory permission to establish a new federal savings bank. This new subsidiary will operate all of Chase’s consumer credit offices located outside of Chase’s home market in the tri-state area surrounding New York City. Chase emphasized that its new federal savings

238 See authorities cited supra note 233; see also Wells, 832 A.2d at 820–22.
239 For discussions of the central importance of geographic expansion, lending, and deposit-taking in the banking industry, see, for example, Wilmarth, Too Big to Fail, supra note 49, at 960–66, 972–77, and Wilmarth, Transformation, supra note 139, at 227–72.
240 See Liz Moyer, Chase Seeks FSB Charter, Hints at New Markets, AM. BANKER, Sept. 11, 2003, at 1. For the most recent of the OTS’s opinions barring the application of state predatory lending laws to federal thrifts, see OTS Op. Chief Counsel No. P-2003-6, Sept. 2, 2003 (declaring that federal law preempts the New Mexico Home Loan Protection Act). For a discussion of other recent OTS opinion letters that similarly declared that federal savings associations were exempt from a variety of state consumer protection laws related to lending practices, see Neumeier & Szukala, supra note 227, at 625–27, 630–31.
241 See Ira L. Tannenbaum, Federal Thrift Charter Popularity Continues, 18 BANKING POL’Y REP. No. 3, Feb. 1, 1999, at 1, 16 (noting that OTS rules enable federal savings associations to conduct “interstate activities” based on a “preemption of state laws . . . [that] is broader than the scope of preemption applicable to the activities of national banks”); A Unified Federal Charter for Banks and Savings Associations: A Staff Study, 10 FDIC BANKING REV. No. 1, at 1, 3–4 (1997) (stating that “[t]he federal thrift charter confers the broadest geographic expansion authority of any federal insured depository institutions charter,” while national and state banks continue to be subject to restrictions on the establishment of de novo interstate branches under the Riegle-Neal Act); Gregory J. Lyons, A Low-Profile Charter That Offers More Bang for the Buck, AM. BANKER, Nov. 12, 2003, at 17A (reporting that “the OTS has been very aggressive in preempting state laws” for federal thrifts, and such institutions “can easily branch on a nationwide basis”).
bank will be able to “operate federally regulated businesses under a single national standard and have greater flexibility in opening branches in select markets across the country.”\textsuperscript{242}

As discussed in Part II, the OCC’s new preemption rules seek to provide national banks with the same sweeping immunity from state laws that federal savings associations are granted under the OTS’s rules.\textsuperscript{243} Chase’s decision 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,”\textsuperscript{244} strongly indicates that the OCC’s rules are likely to persuade most of the largest state-chartered banks to convert to national charters. As discussed previously, the migration of large state banks to the national banking system would greatly weaken the state banking system and would destroy the competitive equilibrium that currently exists within the dual banking system.\textsuperscript{245} Such a drastic outcome should not occur without Congress’s explicit authorization.

D. The OCC’s Preemption Rules and Recent Lower Court Decisions Are Contrary to Longstanding Judicial Precedents and Congressional Policy Regarding the Application of State Laws to National Banks

1. In Recent Years, the OCC and Large National Banks Have Used a Coordinated Litigation Strategy to Preempt State Consumer Protection Laws

As explained above, judicial precedents and federal legislation reject any notion that federal law “occupies the field” with regard to the

\textsuperscript{242} Moyer, supra note 240 (quoting statement issued by a Chase representative); see also Damian Paletta, In Brief: JPM Chase Gets Final Approval for Thrift, AM. BANKER, Feb. 2, 2004, at 20 (reporting that Chase’s new federal savings bank “is meant to serve a national market . . . [and] will include 302 consumer-lending offices [established by Chase] outside the tri-state New York region, New Jersey and Connecticut”).

\textsuperscript{243} See supra notes 19–32 and accompanying text.

\textsuperscript{244} Moyer, supra note 240 (quoting Matthew Lee, executive director of Inner City Press/Community on the Move).

\textsuperscript{245} See supra notes 193–211 and accompanying text. Mr. Cayne and Ms. Perkins claim that my “dire predictions” regarding the threat posed by the OCC’s rules to the dual banking system lack “any credible foundation.” Cayne & Perkins, supra note 2, at 372. However, they do not consider the virtual collapse of the state-chartered thrift system that occurred after 1975, and they do not offer any explanation that would challenge my thesis that the FHLBB’s and OTS’s preemption rules were the most likely cause of that collapse.
business operations of national banks. The Supreme Court has consistently held that state laws apply to national banks unless such laws conflict with the express statutory powers of national banks, discriminate against national banks, or place an undue burden on the operations of national banks. The House-Senate conferees on the Riegle-Neal Act endorsed this long-established judicial presumption in favor of applying state law to the activities of national banks.

Contrary to these judicial and legislative authorities, the OCC claimed in the preamble to its visitorial powers rule that “there is no presumption against preemption in the national bank context.” As support for this assertion, the OCC cited the Ninth Circuit’s recent decision in Bank of America. In Bank of America the Ninth Circuit held that “the presumption against preemption of state law is inapplicable” in the course of deciding that national banks did not have to comply with local ordinances prohibiting surcharges on persons using bank ATMs. The Ninth Circuit contended that its refusal to apply a presumption in favor of state law was consistent with the Supreme Court’s decision in United States v. Locke.

However, the Ninth Circuit’s reliance on Locke was clearly misplaced. In Locke, the Supreme Court declined to apply “an ‘assumption’ of nonpre-emption” in striking 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.” 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.

246 See supra Parts III.A and III.B.
248 See supra notes 163–69 and accompanying text.
250 Id. at 1896–97, 1896 n.11 (citing and quoting Bank of Am. v. San Francisco, 309 F.3d 551, 559 (9th Cir. 2002)).
251 Bank of Am., 309 F.3d at 559.
253 Id. at 108.
254 Id. (emphasis added).
Accordingly, the Court refused in *Atherton* to adopt a federal common-law rule for federally-chartered banks that would override state-law standards governing the fiduciary duties of bank directors.  

The Ninth Circuit’s refusal to apply a presumption against preemption in *Bank of America* was clearly inconsistent with the Supreme Court’s holding in *Atherton*. The Ninth Circuit also ignored other Supreme Court decisions and the explicit instructions of the Riegle-Neal conferees, all of which support the presumptive application of state laws to national banks.

Unfortunately, *Bank of America* is not an isolated example. Notwithstanding the OCC’s clear departure from established principles governing the dual banking system, the OCC has been successful during the past six years in persuading federal appellate and district courts to issue decisions preempting state consumer protection laws. The OCC and its national bank allies have generally followed a three-step strategy in these cases. First, the OCC has issued interpretive rules and opinion letters that aggressively fill in “gaps” where the National Bank Act is silent regarding the extent of national bank powers. For example, the OCC adopted a wide array of interpretive rules defining the “incidental powers” of national banks under 12 U.S.C. § 24(Seventh). As support for its authority to specify the “incidental powers” of national banks, the OCC relied on *NationsBank of North Carolina v. Variable Annuity Life Ins. Co* ("VALIC"). In *VALIC* the Supreme Court held that the OCC’s opinion is entitled to “controlling weight” under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* whenever the OCC makes a “reasonable” determination that a particular activity falls within the “incidental powers” of national banks under § 24(Seventh).

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257 For example, see 12 C.F.R. pt. 7 (2003), and especially the preemption rulings contained in 12 C.F.R. §§ 7.4000–7.4006.


260 See *VALIC*, 513 U.S. at 256–60. *Chevron* sets forth a two-step test for determining whether the courts should defer to an agency’s interpretation of its statutory
The deference granted to the OCC by the Supreme Court in VALIC has encouraged lower courts in subsequent cases to accept the OCC’s interpretations of the “incidental powers” of national banks. Accordingly, as the second prong of its preemption strategy, the OCC has used its “incidental powers” rulings to create conflicts with state law in areas where federal statutes are silent regarding the authority of national banks. For example, § 24(Seventh) of the NBA and other federal statutes do not specifically empower national banks to impose service fees on their customers. Nevertheless, the OCC issued broad interpretive rulings declaring that national banks have the “incidental power” to charge service fees in accordance with their business judgment and without regard to limitations imposed by state law. The OCC issued similar preemptive rulings in other areas related to consumer banking services based on its liberal interpretations of the “incidental powers” of national banks.

mandate. Under step one, the court must ask “whether Congress has directly spoken to the precise question at issue.” Chevron, 467 U.S. at 842. If so, the court “must give effect to the unambiguously expressed intent of Congress” and must “reject administrative constructions that are contrary to clear congressional intent.” Id. at 843, 843 n.9. If, however, the governing statute is “silent or ambiguous with respect to the specific issue,” step two of Chevron requires the court to defer to any “reasonable interpretation” made by the agency. Id. at 843–44. In reviewing the OCC’s opinions regarding the “incidental powers” of national banks under § 24(Seventh), the courts have generally deferred to the OCC under step two of Chevron unless another federal statute clearly indicates that the OCC lacks authority to approve the activity in question. Compare, e.g., VALIC, 513 U.S. at 256–60 (deferring to the OCC’s interpretation of § 24(Seventh)), and Bank of Am. v. San Francisco, 309 F.3d 551, 563 (9th Cir. 2002) (same), cert. denied, 538 U.S. 1069 (2003), with Indep. Ins. Agents of Am., Inc. v. Hawke, 211 F.3d 638, 643–45 (D.C. Cir. 2000) (refusing to defer to the OCC’s interpretation of § 24(Seventh) because the insurance activity approved by the OCC was barred by the clear terms of 12 U.S.C. § 92), and Am. Land Title Ass’n v. Clarke, 968 F.2d 150, 154–57 (2d Cir. 1992) (same), cert. denied, 508 U.S. 971 (1993).


262 See, e.g., Wells Fargo Bank of Tex. v. James, 321 F.3d 488, 492–93 (5th Cir. 2003) (citing an interpretive rule and opinion letters issued by the OCC stating that national banks have authority to charge check-cashing fees); Bank of Am., 309 F.3d at 562–63 (citing interpretive rules and opinion letters issued by the OCC, declaring that national banks have authority to impose surcharges on transactions by non-depositors at their ATMs).

263 See, e.g., Wells Fargo Bank v. Boutris, 265 F. Supp. 2d 1162, 1165 (E.D. Cal. 2003) (citing OCC interpretive rules providing that (i) national banks may establish
As the third step in its litigation strategy, the OCC has frequently filed amicus briefs to support preemption claims asserted by national banks in judicial proceedings. In turn, the national banks appearing as parties in those cases have argued that the courts must defer to the OCC’s interpretation of the NBA. In several recent cases, federal appellate and district courts deferred to the OCC’s view that state consumer protection laws were preempted by reason of “conflicts” with the “incidental powers” of national banks as defined by the OCC in its interpretive rulings and amicus briefs. In three of those decisions, the courts deferred to the OCC’s preemption claims, based on the OCC’s interpretation of § 24(Seventh), even though other federal statutes applied to the financial transactions at issue and expressly authorized the states to enact more restrictive laws regulating those transactions.

operating subsidiaries to engage in mortgage lending and (ii) such operating subsidiaries are immune from state regulation because they are subject to the “exclusive ‘visitorial’ power” of the OCC; Am. Bankers Ass’n v. Lockyer, 239 F. Supp. 2d 1000, 1015–16 (E.D. Cal. 2002) (citing two OCC opinion letters declaring that state laws were preempted because (i) in one case, the relevant state law imposed “burdens” that would “increase a bank’s operating costs and substantially hamper the bank’s marketing activities” for insurance sales and (ii) in another case, the pertinent state law “frustrated [national banks’] ability to conduct their [motor vehicle] leasing businesses in an economically efficient manner”).

264 See James, 324 F.3d at 492–95 (citing VALIC and deferring to the OCC’s view—expressed in interpretive rules, opinion letters and an amicus brief—that (i) national banks have the “incidental power” to charge check-cashing fees and (ii) federal law therefore preempted a Texas statute prohibiting financial institutions from charging fees for cashing “on us” checks); Bank of Am., 309 F.3d at 557–64 (citing VALIC and deferring to the OCC’s similarly-expressed position that (i) national banks have the “incidental power” to charge fees for transactions at their ATMs and (ii) federal law therefore preempted two California municipal ordinances prohibiting financial institutions from imposing ATM surcharges on non-depositors); Bank One, Utah v. Guttau, 190 F.3d 844, 850 (8th Cir. 1999) (deferring to the OCC’s similarly-expressed view that an Iowa statute regulating ATMs was preempted as to national banks because the statute imposed a “significant burden” on the ability of national banks to offer services at their ATMs), cert. denied sub nom. Foster v. Bank One, Utah, 529 U.S. 1087 (2000); Boutris, 265 F. Supp. 2d at 1165–70 (deferring to the OCC’s similarly-expressed claim that California’s authority to regulate an operating subsidiary of a national bank was preempted by reason of (i) the national bank’s “incidental power” to establish the subsidiary and (ii) the OCC’s “exclusive visitorial power” over the subsidiary); Lockyer, 239 F. Supp. 2d at 1013–16 (deferring to the OCC’s similarly-expressed position that a California statute requiring certain disclosures to credit card customers was preempted as to national banks because the statute imposed “significant costs on national bank lending”).

265 See Bank of Am., 309 F.3d at 563–66 (deferring to the OCC’s view that (i) the
Thus, the OCC and national banks have used a coordinated litigation strategy to expand the preemptive reach of the NBA. In *James* the Fifth Circuit seemed to recognize that the OCC has an inherent conflict of interest whenever it issues a preemptive ruling regarding the “incidental powers” of national banks. The court noted that the beneficiaries of the OCC’s preemptive rulings are the “regulated industry”—the same national banks that fund the OCC’s budget.

Nevertheless, even though the NBA is silent regarding the authority of national banks to charge service fees, the Fifth Circuit felt powerless to second-guess the OCC’s claim that its interpretive rulings on service fees preempted state law. The court concluded that *VALIC* and *Chevron* mandated deference to the OCC’s position:

> [W]hile divining the intent of Congress with respect to a point of policy not statutorily addressed is possibly aspirational under the best of circumstances, and particularly so where, as here, congressional purpose must be inferred from a vague and expansive delegation of authority to an administrative agency, we think it plain that the OCC has been delegated the authority to determine, with a considerable discretionary birth [sic], whether and which fees the national banks may assess. . . .

> [I]n exercising the discretion committed it by Congress, an agency necessarily, and perhaps even inadvertently, sweeps into its legislative reach significant policy decisions outside its area of specific commitment. . . . Here, the constituency positively affected by the OCC’s position is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is

“incidental power” of national banks to charge fees for ATM transactions preempted the anti-surcharges ordinances adopted by two California municipalities and (ii) the challenged ordinances could not be justified under the federal Electronic Funds Transfer Act (“EFTA”), even though the EFTA expressly allows states to adopt laws governing electronic funds transactions that are more restrictive than the federal standards established under the EFTA; *Guttau*, 190 F.3d at 850–51 (similarly deferring to the OCC’s position that the challenged Iowa statute could not be justified under the EFTA); *Lockyer*, 239 F. Supp. 2d at 1008–09, 1013–15 (deferring to the OCC’s view that California’s credit card disclosure law conflicted with “national banks’ general powers under the NBA,” even though the federal Truth in Lending Act (“TILA”) expressly allows states to adopt laws governing the disclosure of credit terms that are more restrictive than the federal standards established under TILA).

266 *James*, 321 F.3d at 488.

267 *Id.* at 494; see also 2004 Georgetown Lecture by Spitzer, *supra* note 201, at 7 (observing that the “OCC’s entire operating budget” is “funded directly by the entities that it oversees”); *supra* notes 159–61 and accompanying text.

268 *James*, 321 F.3d at 493–95.
adversely affected by the OCC’s decision, though vast, is diffuse, unorganized, and definitionally ill-funded. It may be that these competing interests could be better balanced by a national Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry. However, our review here is limited to discerning whether Congress intended to delegate this question to the OCC, not whether we think such a delegation wise.

. . .

. . . We conclude . . . that the OCC interpretation is not a clearly erroneous interpretation, and the district court properly deferred to it.269

2. In View of the OCC’s Self-Interest in Preempting State Law to Attract Large Banks to Its Regulated Constituency, the Courts Should Not Give Chevron Deference to the OCC’s Preemption Rulings

As shown in the preceding section, recent federal appellate and district court decisions have upheld the OCC’s preemption rulings in reliance on the deference given to the OCC by the Supreme Court in VALIC. In granting such deference, those recent decisions have overlooked two important points. First, in VALIC the central issue was whether the OCC’s opinion letter was consistent with federal statutes limiting the powers of national banks.270 The OCC’s ruling did not contain a preemptive determination and was not offered as a justification for overriding state law. Accordingly, VALIC simply did not address the question of whether an OCC ruling should receive Chevron deference when the ruling either contains, or is used to support, a preemption claim. Second, and more generally, the Supreme Court has never ruled definitively on the question of whether a federal agency is entitled to Chevron deference when it issues a preemption determination. Two recent decisions of the Supreme Court suggest that the Court might adopt the view that a federal agency’s claim of authority to preempt state law should be reviewed de novo by the judiciary, without giving Chevron deference to the agency’s interpretation of its statutory mandate.271

269 Id. (citing, inter alia, VALIC and Chevron).


271 In Smiley v. Citibank (S. Dakota), 517 U.S. 734 (1996), the Court upheld the
validity of an OCC interpretive regulation that defined the term “interest” for purposes of 12 U.S.C. § 85. The petitioner argued that the OCC’s regulation should not be given Chevron deference because the effect of the regulation was to preempt state laws restricting the amount of late fees charged for overdue payments on loans. According to the petitioner, “the ‘presumption against . . . pre-emption’ announced in Cipollone v. Liggett Group, Inc., 505 U.S. 504, 518 (1992), in effect trumps Chevron, and requires a court to make its own interpretation of § 85 that will avoid (to the extent possible) pre-emption of state law.” Smiley, 517 U.S. at 743–44 (describing petitioner’s argument). The Court assumed, without deciding, that “the question of whether a statute is pre-emptive . . . must always be decided de novo by the courts.” Id. at 744 (emphasis in original). The Court, held, however, that this assumed principle was not applicable in Smiley, because (i) the Court had declared in a previous case that § 85 preempted state law and (ii) the OCC’s regulation only defined the “meaning” of a term used in § 85 and therefore “does not . . . deal with pre-emption, and hence does not bring into play the considerations petitioner raises.” Id.

In summarily dismissing the petitioner’s Chevron argument, the Court in Smiley overlooked the rather obvious fact that the OCC’s regulation adopted a very broad definition of “interest,” thereby increasing the effective scope of preemption under § 85. The OCC’s definition of “interest” included not only conventional “numerical periodic fees,” but also a variety of lump-sum fees that are not based on time or rate-based considerations, such as late fees, over-the-limit fees, and bounced check charges. See id. at 740. Nevertheless, it is noteworthy that the Court reserved judgment on the petitioner’s claim that agency regulations containing preemptive interpretations of statutes should not be given Chevron deference and should instead be reviewed de novo by the courts.

In New York v. Federal Energy Regulatory Commission, 535 U.S. 1 (2002), the State of New York challenged a FERC regulation that preempted state law by its own terms. New York argued that the Supreme Court should apply a “presumption against pre-emption” in determining whether FERC had statutory authority to adopt such a regulation. The Court rejected New York’s arguments in the following terms:

[A] federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority[,] . . . [for] an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it.” . . . Such a case does not involve a “presumption against pre-emption,” as New York argues, but rather requires us to be certain that Congress has conferred authority on the agency. . . . In other words, we must interpret the statute to determine whether Congress has given FERC the power to act as it has, and we do so without any presumption one way or the other.

Id. at 18 (citations omitted and emphasis added).

In New York v. FERC, the majority opinion written by Justice Stevens (the author of Chevron) did not refer to Chevron in the course of deciding whether FERC had statutory authority to adopt the preemptive regulation at issue. See id. at 18–25. In contrast, the Supreme Court agreed with the ruling of the Court of Appeals that Chevron deference should be given to the agency’s decision to refrain from exercising
At least one federal appeals court held that federal agency preemption determinations should not receive *Chevron* deference, while another court of appeals reserved judgment on that issue.\(^{272}\) One reason why preemption determinations are poor candidates for *Chevron* deference is that they “involve matters of law—an area more within the expertise of the courts than within the expertise of the [agency].”\(^{273}\) A second reason is that an agency typically enlarges the scope of its jurisdiction and effective power when it issues preemption determinations. The Supreme Court has “never resolved the question of whether there should be a ‘scope of jurisdiction’ exception to *Chevron* deference.”\(^{274}\) However, some commentators

all of its potential authority under the governing statute. *See id.* at 15–16, 26–28. Thus, two aspects of *New York v. FERC* indicate that questions about the scope of an agency’s statutory authority to adopt preemptive rules should be decided de novo by the court, without giving *Chevron* deference to the agency’s interpretation of the governing statute. First, as noted above, the Court stated that the question of whether FERC had statutory authority to adopt preemptive regulations should be decided “without any presumption one way or the other.” *Id.* at 18. Second, the Court did not rely on *Chevron* in affirming the FERC’s authority to preempt state law, but the Court did cite *Chevron* in upholding the agency’s discretionary decision not to exercise all of its available authority.


\(^{273}\) *Harmon*, 951 F.2d at 1579; *see also* Nat’l Mining Ass’n v. Sec’y of Labor, 153 F.3d 1264, 1267 (11th Cir. 1998) (refusing to grant *Chevron* deference to a federal agency’s decision on “a question of pure statutory construction” and citing *Harmon* in support of that conclusion).

\(^{274}\) Thomas W. Merrill & Kristin E. Hickman, *Chevron’s Domain*, 89 Geo. L.J. 833, 844 (2001). In *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), the Supreme Court held that an order issued by FERC preempted a conflicting decision of the Mississippi Supreme Court. Justice Brennan (joined by Justices Marshall and Blackmun) argued in dissent that the Supreme Court should not defer to “an agency’s interpretation of a statute designed to confine the scope of its jurisdiction.” *Id.* at 387 (Brennan, J., dissenting). Justice Brennan contended that “the normal reasons for agency deference” do not apply in such a case, because (i) the statutory “policies in favor of limiting the agency’s jurisdiction . . . may indeed conflict . . . with the agency’s institutional interests in expanding its own power” and (ii) “we cannot presume that Congress implicitly intended an agency to fill ‘gaps’ in a statute confining the agency’s jurisdiction, *Chevron*, 467 U.S. at 843–44, since by its nature such a statute manifests an unwillingness to give the agency freedom to define the scope of its own power.” *Id.* In response, Justice Scalia argued in his concurring opinion that “giving deference to an administrative interpretation of its statutory jurisdiction or authority is both necessary and appropriate.” *Id.* at 381 (Scalia, J., concurring). Justice Scalia maintained that Justice Brennan’s proposed jurisdiction-
believe that *Chevron* deference should not be given to an agency interpretation that expands the boundaries of the agency’s mandate, because “agencies have no comparative advantage in reading statutes and . . . agency self-interest may cloud its judgment.”

The same concerns about “agency self-interest” and “agency aggrandizement” are clearly at stake when the OCC issues interpretive rulings or substantive regulations that purport to preempt state law. Public policy does not favor granting *Chevron* deference to such rulings because—as shown in this article and a recent speech by New York Attorney General Eliot Spitzer—(i) the OCC forcefully proclaims the benefits of preemption for its regulated national bank constituents (especially large, multistate national banks), (ii) those constituents publicly applaud the OCC’s efforts to preempt state law, (iii) the same constituents provide virtually all of the funding for the OCC’s operations, (iv) in recent years the OCC and some of its largest constituents have actively pursued a carefully coordinated litigation strategy designed to obtain court decisions preempting state law, (v) a successful outcome of the OCC’s various preemption initiatives will likely enlarge the OCC’s constituency and thereby expand the OCC’s budget and prestige, and (vi) the OCC’s preemption claims greatly expand the sphere of its “exclusive” regulatory control to include

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275 Ernest Gellhorn & Paul Verkuil, *Controlling Chevron-Based Delegations*, 20 CARDOZO L. REV. 989, 1009 (1999); *see also* Timothy K. Armstrong, *Chevron Deference and Agency Self-Interest*, 13 CORNELL J.L. & PUB. POL’Y NO. 2 (Spring 2004) (forthcoming), available at http://ssrn.com/abstract 46742 (arguing that agency interpretations of statutes that implicate “agency self-interest”—either by advancing the agency’s financial interests or by expanding the scope of its regulatory powers—should not receive *Chevron* deference and should be reviewed de novo by the courts); Merrill & Hickman, *supra* note 274, at 910–14 (contending that “agency interpretations that affect the scope of their delegated power” should be subject to a “step zero” inquiry; under this approach, an agency would not receive *Chevron* deference unless the “step zero” inquiry revealed that Congress intended the agency to be the “primary interpreter” of the scope of its jurisdiction).

276 Gellhorn & Verkuil, *supra* note 275, at 994.
state-chartered corporations that are subsidiaries of national banks.\textsuperscript{277} The misgivings voiced by the Fifth Circuit in James\textsuperscript{278} should have caused that court to deny the OCC’s claim for Chevron deference. The decisions in James and other recent cases might well have been different if the courts had subjected the OCC’s preemptive rulings to a searching, de novo review that carefully considered whether the OCC’s interpretations of the NBA were truly consistent with the judicial precedents and congressional policies discussed in Parts III.A and III.B.

During 2003 and early 2004 more than forty members of Congress publicly challenged the OCC’s authority to implement its preemption initiatives.\textsuperscript{279} While these public statements by members of Congress

\textsuperscript{277} See Armstrong, supra note 275 (contending that “agency self-interest” is implicated and should preclude the availability of deference under Chevron whenever an agency’s interpretation of a statute is shown to further “the agency’s financial self-interest” or “to aggrandize regulatory power in the agency” by “expand[ing] the agency’s regulatory sphere”); 2004 Georgetown Lecture by Spitzer, supra note 201, at 6–13 (describing the OCC’s powerful incentives for issuing aggressive preemption rulings and otherwise shielding its regulated constituents from state enforcement efforts); supra notes 19–32, 191–203, 257–67 and accompanying text and infra Parts III.G and III.H.2 (same).

\textsuperscript{278} See James, 321 F.3d at 493–94; see also supra notes 266–69 and accompanying text.

\textsuperscript{279} See Todd Davenport, In Brief: Dems: Proposed Rules Beyond OCC’s Scope, AM. BANKER, Nov. 25, 2003, at 3 (reporting that the ten Democratic members of the Senate Banking Committee sent a letter to the OCC (i) declaring that “[t]he OCC now appears to be ignoring both the Supreme Court and Congress by pursuing a preemption agenda that would override any state law that has any impact on a national bank” and also stating that “[t]he OCC’s actions and proposals would dramatically alter established preemption standards and would radically affect state-federal relations and consumer protection in the areas of banking”; and (ii) asking the OCC “to defer any further rulemaking on preemption of state laws at this time”); Davenport, OCC and Georgia Law, supra note 197 (reporting that sixteen members of the House Financial Services Committee had written to the OCC, warning that the OCC’s preemption initiatives “could result in Congress having to act . . . to curb the OCC’s preemption authority”); National Banks: Kelly Seeks Delay on OCC Preemption Rules; Agency Will ‘Stay the Course,’ Williams Says, 82 Banking Rep. (BNA) 191 (Feb. 2, 2004) (reporting that, during a House subcommittee oversight hearing, several members criticized the OCC’s preemption and visitorial powers rules and only one member defended the OCC); House Subcommittee Scrutinizes OCC Preemption Rule, CSBS EXAMINER, Jan. 30, 2004, at 1, available at http://www.csbs.org (same); Karen L. Werner, Preemption: Frank, House Democrats Urge OCC to Delay Effective Date of Rulemaking, 82 Banking Rep. (BNA) 283 (Feb. 16, 2004) (reporting that twenty-three members of the House Financial Services Committee had called upon the OCC to defer any final implementation of its preemption and visitorial powers rules);
do not have binding legal force, they support my view that the OCC’s preemption rules fall outside the boundaries of the agency’s statutory authority.

E. The OCC Does Not Have Authority to Provide National Banks with a General Exemption from State Laws in the Area of Real Estate Lending

1. Section 371(a) Does Not Authorize the OCC’s Real Estate Lending Rule

As amended in January 2004, 12 C.F.R. § 34.4(a) preempts all state laws that “obstruct, impair, or condition a national bank’s ability to fully exercise its Federally authorized real estate lending powers . . . .” Amended § 34.4(b) allows a narrow subset of state laws to apply to national banks, but only to the extent that such laws have an “incidental” effect on the real estate lending activities of national banks. The OCC explained that state laws will be deemed “incidental” if they “do not attempt to regulate the manner or content of national banks’ real estate lending, but . . . instead form the legal infrastructure that makes it practicable to exercise a permissible Federal power.” In other words, only those state laws that promote the ability of national banks to make real estate loans will remain applicable under § 34.4.

Michelle Heller, Mixed Views on Impact of Panel’s Preemption Vote, AM. BANKER, Feb. 27, 2004, at 3 (reporting that the House Financial Services Committee adopted, by a 34-28 vote, a budget-related resolution “to chastise the [OCC] for issuing [its rules] without congressional authorization and without increasing the agency’s enforcement personnel or budget”). The budget-related resolution of the House Financial Services Committee is set forth in VIEWS AND ESTIMATES OF THE COMM. ON FIN. SERV. ON MATTERS TO BE SET FORTH IN THE CONCURRENT RES. 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 15–16; see also id. at 25–26 (committee’s record vote of 34-28 on the resolution); id. at 39 (“Additional Views” of six committee members who stated that they would have voted “no” if they had been present for the committee’s vote on the resolution).

280 OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1917 (text of 12 C.F.R. § 34.4(a) (2003)).

281 Id. (text of 12 C.F.R. § 34.4(b) specifying that state laws dealing with contracts, torts, criminal law, homestead laws, rights to collect debts, acquisition and transfer of real property, taxation, and zoning apply to national banks, but only if they have a permissible “incidental” effect).

282 Id. at 1912.
As described in Part II, amended § 34.4 adopts essentially the same preemption standard for real estate lending by national banks that the OTS established for lending by federally-chartered thrifts. Unlike the OTS’s rule, § 34.4 does not explicitly “occupy the field” of real estate lending by national banks, but in practical effect it does so in everything but name.\footnote{Compare id. at 1917 (text of 12 C.F.R. § 34.4) with 12 C.F.R. § 560.2 (2003). See supra notes 19–32 and accompanying text.}

Prior to its recent amendments to § 34.4, the OCC never asserted a blanket preemption of state laws in the area of real estate lending. The previous version of § 34.4(a) preempted state laws only in five specific areas related to real estate loans—viz., loan-to-value ratios, amortization schedules, maturity rules, aggregate lending limits, and leaseholds used as loan collateral.\footnote{12 C.F.R. § 34.4(a).} With respect to all other state regulations affecting real estate loans, the previous version of § 34.4(b) stated that the OCC would address preemption issues on a case-by-case basis in accordance with “recognized principles of Federal preemption.”\footnote{Id. § 34.4(b).}

The OCC’s recent amendments to § 34.4 plainly exceed the agency’s rulemaking authority with respect to real estate loans under 12 U.S.C. § 371(a).\footnote{Section 371(a) provides that national banks may make real estate loans “subject to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.”\footnote{12 U.S.C. § 371(a).} Pursuant to § 1828(o), the federal banking agencies adopted “uniform standards” governing real estate loans made by all FDIC-insured institutions, taking into consideration (i) the risk of such loans to the deposit insurance funds, (ii) “the need for safe and sound operation of insured depository institutions,” and (iii) “the availability of credit.”\footnote{See id. § 1828(o)(2)(a). For the uniform interagency standards on real estate lending adopted pursuant to § 1828(o), see 12 C.F.R. § 34.62(a)–(d), pt. 34 subpt. D app. A (text of real estate lending standards for national banks as adopted by the OCC pursuant to § 1828(o)); Real Estate Lending Standards, 57 Fed. Reg. 62,890 (Dec. 31, 1992) (notice of final interagency standards on real estate lending adopted by federal banking agencies pursuant to § 1828(o)).}

\footnote{The OCC claimed that its amendments to § 34.4 fall within its rulemaking power under 12 U.S.C. § 371(a) (2000). See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1909–10.}
these uniform standards cannot be changed unless they are “uniformly amended by the appropriate Federal banking agencies, acting in concert.”

Thus, § 1828(o) expressly limits the rulemaking authority granted to the OCC under § 371(a). Section 1828(o) does not include any statement of a congressional intent to “occupy the field” of real estate lending by FDIC-insured depository institutions. Instead, § 1828(o) indicates a congressional purpose to ensure that all FDIC-insured institutions—including national and state banks—have an equal competitive opportunity to make real estate loans based on the same “uniform standards,” which cannot be altered unless they are “uniformly amended” by all federal banking agencies. Significantly, the uniform interagency standards established under § 1828(o) require each FDIC-insured institution to adopt lending policies that take into account “[c]ompliance with all real estate related laws and regulations,” a phrase that on its face includes applicable state laws. Thus, the uniform interagency standards do not allow the OCC to issue regulations under § 371(a) that provide national banks with a general exemption from state laws related to real estate transactions.

Prior to 1991, § 371(a) authorized national banks to make real estate loans “subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation.” In 1982 Congress amended § 371(a) by repealing statutory provisions that previously specified maximum loan-to-value (“LTV”) ratios, amortization requirements, maturity requirements, aggregate lending limits, and leasehold collateral requirements for real estate loans made by national banks. In place of these statutory requirements, the 1982 amendment to § 371(a) gave the OCC sole discretion to determine the “terms, conditions, and limitations” that would govern real estate lending by national banks.

OCC issued new real estate lending rules, which removed all quantitative restrictions on real estate lending and allowed national bank managers to exercise business judgment in setting the terms of their real estate loans.\textsuperscript{293}

In 1991 Congress adopted § 1828(o) and amended § 371(a) to require national banks to comply with the uniform interagency standards mandated by § 1828(o).\textsuperscript{294} In contrast to the broad authority granted to the OCC in 1982, the current language of § 371(a) makes clear that (i) the uniform interagency standards approved under § 1828(o) establish the primary guidelines for real estate lending by national banks and (ii) the OCC has authority to prescribe, by regulation or order, only such additional “restrictions and requirements” as are consistent with the uniform standards mandated by § 1828(o). Thus, the OCC’s rulemaking authority under § 371(a) is currently far more circumscribed than it was prior to 1991.

In 1992, when the federal banking agencies adopted the uniform standards required by § 1828(o), the agencies recognized that (i) the “flexible approach” adopted by the OCC in its 1983 rules allowed national banks to make “imprudent” real estate loans and (ii) widespread defaults on those loans inflicted massive losses on both national banks and the deposit insurance fund in the late 1980s and early 1990s. The agencies explained that the new uniform standards would impose prudential requirements on national banks for the purpose of preventing any recurrence of the “abusive” lending practices that occurred under the OCC’s permissive 1983 rules.\textsuperscript{295}

\textsuperscript{293} See Final Rule, 48 Fed. Reg. 40,698 (Sept. 9, 1983) (rulemaking notice containing the real estate lending regulations adopted by the OCC in 1983).


\textsuperscript{295} In the preamble to the notice of final rulemaking for the uniform standards, the federal banking agencies stated: “The legislative history of [§ 1828(o)] indicates that Congress wanted to curtail abusive real estate lending practices in order to reduce risk to the deposit insurance funds and enhance the safety and soundness of insured depository institutions.” Final Rule, 57 Fed. Reg. 62,890, pt. II(A) (Dec. 31, 1992).

Previously, when the OCC requested comments on the uniform standards as originally proposed, the OCC explained the reasons for Congress’s decision to require the new standards:

Prior to 1982, national bank real estate lending was governed by statutory and regulatory requirements relating to five aspects of lending activity: Loan-to-value (LTV) ratios, amortization requirements, maturity requirements, aggregate limits, and leasehold requirements. The Garn-St. Germain Depository Institutions Act of 1982 removed statutory restrictions on real estate
The original version of 12 C.F.R. § 34.4—which deals with the issue of preemption in the context of real estate lending—was adopted by the OCC as part of its 1983 rules.\(^{296}\) The preamble to the 1983 rules stated that the OCC was removing quantitative restrictions on national bank real estate loans in five areas where Congress removed statutory restraints—viz., limits on LTV ratios, amortization requirements, maturity requirements, aggregate lending limits, and leasehold collateral requirements.\(^{297}\) The preamble also explained that § 34.4(a) would preempt state laws in the same five areas because the application of state laws in those areas would “conflict . . . with Congressional intent” by “imposing, on national banks, restrictions similar to those eliminated.”\(^{298}\) The OCC emphasized that preemption created by the 1983 version of § 34.4 would have only a “limited scope”:

The OCC is preempting, at this time, only those state laws that govern those areas in which federal limitations and restrictions are eliminated. This is to preclude [sic] any conflict of state law with lending by national banks. The OCC was given authority [under amended § 371(a)] to impose conditions and limitations by regulation or order.

In 1983, the OCC rescinded the existing regulations on real estate lending, including loan-to-value ratios. . . . [I]t was felt that prudent lending and the safety and soundness of the national banks were better served by a flexible approach that allowed institutions to tailor their policies to differences in market conditions and management philosophies, rather than strict quantitative standards applied uniformly to all institutions. As the OCC stated at the time, “Decisions concerning the forms and terms of national bank lending are properly the responsibility of each bank’s directorate and management.”

. . . .

In subsequent years, some institutions made imprudent real estate-related loans that required little or no equity investment on the part of the borrower, with costly consequences to financial institutions, the real estate industry, and the federal bank and thrift insurance funds. The proposed regulation [adopting uniform standards as required by Congress under § 1828(o)], which would limit LTV ratios for real estate lending, is intended to insure that this problem does not recur.


\(^{297}\) Id. at 40,698–700.

\(^{298}\) Id.
Congressional intent and the intent of the [OCC] in removing the regulatory restrictions. The final rule clarifies the limited scope of the preemption. Aside from the specific preemption of state law as to the restrictions discussed, the relationship between state and federal law in regard to real estate loans as it existed prior to the amendment of 12 U.S.C. 371 is expected to remain unchanged.299

Thus, the OCC’s 1983 rules recognized that Congress had not expressed any intent to bar the states from regulating real estate loans made by national banks with respect to matters falling outside the five designated areas. The OCC adopted its 1983 rules shortly after a federal appeals court issued its decision in CSBS v. Conover.300 In that case, the court upheld OCC regulations preempting state laws that limited the ability of national banks to make adjustable-rate mortgage loans. The decision in Conover was based entirely on principles of conflict preemption and did not indicate that the OCC could authorize a blanket preemption of state laws with respect to real estate lending under § 371(a).301 Thus, the “limited scope” of the preemption announced in the OCC’s 1983 rules was consistent with the court’s reliance on conflict preemption principles in Conover.

Similarly, when the OCC amended § 34.4 in 1996, the OCC declared that its amendment “summarize[d] the OCC’s general approach to questions of Federal preemption of State laws governing real estate lending” while emphasizing that this clarification “[did] not expand the scope of State law preemption beyond what appear[ed] in the [former] rule.302 Thus, from 1983 through 1996 the OCC followed a consistent approach that disclaimed any intent to “occupy the field” of real estate lending and instead preempted state laws only in five specific areas.

When Congress passed the Riegle-Neal Act in 1994, it clearly understood that the OCC did not have authority to bar the states from regulating real estate loans made by national banks. As discussed above, the conference report on the Riegle-Neal Act endorsed “well-established judicial principles” favoring the application of state laws

299 Id. at 40,700 (emphasis added).
300 710 F.2d 878 (D.C. Cir. 1983).
301 See id. at 883 (stating that “it was undisputed that the [state] banking laws conflict with the Comptroller’s regulations,” and observing that “state laws are generally applicable to national banks only to the extent that they do not conflict with federal law, whether statutory or administrative”).
to the activities of national banks. The conference report declared that “States have a legitimate interest in protecting the rights of their consumers, businesses and communities,” and it also expressed a strong “Congressional concern” with respect to federal agency actions preempting state laws in the following four areas: community reinvestment, consumer protection, fair lending, and establishment of intrastate branches. The Riegle-Neal Act included provisions that (i) generally require local branches of out-of-state national banks to comply with nondiscriminatory host state laws in the four designated areas and (ii) require the OCC to publish a notice and solicit comments from the public whenever the OCC intends to issue a ruling declaring that state laws are preempted in any of the same four areas.

Because the Riegle-Neal Act endorsed the general application of state laws to national banks in the areas of community reinvestment, consumer protection, and fair lending, Congress obviously did not intend for the OCC to issue regulations that preempt all state laws placing “conditions” on real estate loans made by national banks. Congress’s understanding regarding the presumptive application of state laws to the real estate lending activities of national banks was based on the judicial precedents discussed in Parts III.A and III.B.3. Congress’s understanding was also consistent with the OCC’s disclaimer of any intent to preempt state laws except in five specific areas when it adopted its real estate lending regulation in 1983.

In the preamble to its new preemption rules, the OCC argued that state lending laws should be generally preempted because “[m]arkets for credit (both consumer and commercial) . . . are now national, if not international, in scope” and “the elimination of legal and other barriers to interstate banking . . . has led a number of banking

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303 See supra note 164 and accompanying text (quoting the conference report in the Riegle-Neal Act).


305 12 U.S.C. §§ 36(f), 43(a) (2000); see also supra notes 165–68 and accompanying text (discussing §§ 36(f) and 43(a)).

306 See, e.g., McClellan v. Chipman, 164 U.S. 347, 356–61 (1896) (holding that national banks must comply with a state law that prohibited banks from accepting preferential transfers of real estate made by insolvent debtors); Nat’l State Bank v. Long, 630 F.2d 981, 985–87 (3d Cir. 1980) (holding that national banks must make home mortgage loans in compliance with a state anti-redlining statute); see also supra notes 171–72 and accompanying text (citing additional court decisions upholding the presumptive application of state laws to national banks).
organizations to operate . . . on a multi-state or nationwide basis.” According to the OCC, these developments made it imperative for the OCC to “enable national banks to operate to the full extent of their powers under Federal law, without interference from inconsistent state laws, consistent with the national character of the national banking system.” The OCC’s argument is untenable because it contravenes the clear intent of Congress when it adopted the Riegle-Neal Act. As discussed above, the Riegle-Neal Act generally requires out-of-state branches of national banks to comply with host state laws in four designated areas (including three areas that are directly related to lending). In addition, the conference report on the Riegle-Neal Act declared that Congress’s approval of nationwide bank acquisitions and nationwide branching would not change “judicially established principles” that supported the general application of state laws to national banks. Thus, in 1994 Congress mandated that state laws would continue to apply to lending activities of national banks in multistate markets. The OCC cannot override Congress’s policy judgment on this matter.

Courts generally presume that Congress is aware of relevant judicial decisions and administrative rulings when it enacts legislation. In the case of the Riegle-Neal Act, this presumption of congressional knowledge is specifically confirmed by the conference report, which endorsed “well-established judicial principles” favoring the application of state laws to national banks. In a similar case where a federal agency consistently followed a policy of exercising only limited regulatory powers over a designated field and where Congress approved the agency’s policy, the Supreme Court held that the agency could not thereafter abandon that policy and seek to enlarge its

308 Id. at 1908.
309 See supra notes 164–68 and accompanying text.
310 See Bd. of Governors v. Dimension Fin. Corp., 474 U.S. 361, 373–74 (1986) (holding that the FRB’s “rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute”; consequently, the FRB could not rely on its view of the “plain purpose” of the Bank Holding Company Act (“BHCA”) to justify rules that exceeded the FRB’s authority under the “plain language” of the BHCA).
regulatory jurisdiction. In view of the OCC’s decisions in 1983 and 1996 not to mandate a blanket preemption of state laws in the area of real estate lending and Congress’s agreement with that policy in 1994, the OCC’s recent amendments to 12 C.F.R. § 34.4 clearly exceed the agency’s authority under § 371(a).

2. The OCC Has No Authority to Preempt Nondiscriminatory State Laws That Are Reasonably Designed to Prevent Abusive and Unsound Lending Practices

The OCC declared in 2003 that Georgia’s predatory lending law was completely preempted with respect to national banks. Amended § 34.4 is designed to override similar state predatory lending laws based on the OCC’s view that such laws impose burdensome “conditions” on national banks. Notwithstanding its eagerness to preempt state predatory lending laws, to date the OCC has issued only one mandatory regulation to deal with the problem of predatory lending. That rule, contained in amended § 34.3(b), prohibits national banks from making real estate loans “based predominantly on the bank’s realization of the foreclosure or liquidation value of the borrower’s collateral, without regard to the borrower’s ability to repay the loan according to its terms.”

Even this single compulsory rule is weaker than it first appears. The OCC explained that the rule does not prevent a national bank from determining “a borrower’s ability to repay” based on the borrower’s “net worth, [and] other relevant financial resources.” Thus, a

313 See FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 143–61 (2000) (holding that the FDA lacked authority to adopt rules regulating cigarettes as a device for dispensing nicotine, because (i) prior to adopting the challenged rules, the FDA had repeatedly disclaimed any authority to regulate cigarettes as drugs; and (ii) Congress had followed a consistent policy of allowing cigarettes to be sold without FDA regulation, subject to (a) labeling requirements and other public warnings about the health hazards of smoking, and (b) restrictions on marketing and advertising).

314 See supra note 26 (discussing the OCC’s preemption of the GFLA in OCC Docket 03-17).

315 See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1908, 1913 (expressing concerns that “state and local anti-predatory lending laws” were having a “detrimental effect” on national banks, and indicating that such laws “are not applicable to national banks’ operations” under the OCC’s new preemption rules).

316 Id. at 1917.

317 Id. (text of amended 12 C.F.R. § 34.3(b)).

318 Id. at 1911.
A national bank can make a loan that (i) the bank does not expect to be paid from the borrower’s available income and (ii) the bank expects to collect by levying against the borrower’s financial resources and other personal property (including savings accounts, retirement accounts, automobiles and household furnishings), as long as the bank does not depend “predominantly” on the expected foreclosure or liquidation value of the borrower’s collateral. Thus, the OCC’s rule does not prohibit real estate loans that (i) provide a clear opportunity for abusive lending practices with regard to retired persons and other persons living on limited incomes and (ii) potentially place the borrower’s home at risk, as long as the lending bank relies on additional financial resources and personal property of the borrower that are not pledged as collateral for the loan.

The OCC also adopted a rule prohibiting national banks from engaging in “unfair or deceptive trade practices within the meaning of section 5 of the Federal Trade Commission Act”\footnote{15 U.S.C. § 45(a)(1) (2000).} and regulations adopted thereunder by the Federal Trade Commission (“FTC”).\footnote{OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1917 (text of amended 12 C.F.R. § 34.3(c)).} However, the OCC greatly weakened the effect of this rule by declaring that, “we lack the authority . . . to specify by regulation that particular practices, such as loan ‘flipping’ or ‘equity stripping’ are unfair or deceptive . . . . [T]he OCC does not have rulemaking authority to define specific practices as unfair or deceptive under section 5.”\footnote{Id. at 1911 n.55.} While disclaiming any authority to identify specific predatory lending practices as “unfair or deceptive” under the FTC Act, the OCC did not even consider whether it has a comparable authority to designate such abuses as “unsafe or unsound practices” for purposes of its enforcement powers under 12 U.S.C. § 1818.

As a consequence of its decision to refrain from issuing mandatory rules, except for § 34.3(b), the OCC’s standards for combating predatory lending are primarily contained in two advisory letters the agency issued in 2003.\footnote{See id. at 1913 (citing OCC Advisory Letter 2003-2, Feb. 21, 2003 [hereinafter OCC AL 2003-2]; OCC Advisory Letter 2003-3, Feb. 21, 2003 [hereinafter OCC AL 2003-3]).} Those advisory letters merely provide “supervisory guidance” to national banks and do not impose any mandatory restrictions or requirements that would qualify as “regulation[s] or order[s]” within the scope of the OCC’s rulemaking authority.
under 12 U.S.C. § 371(a). The “supervisory guidance” in the OCC’s advisory letters only provides “advice on how national banks should avoid engaging in [predatory lending] practices.” The precatory and non-compulsory nature of the OCC’s advisory letters is made clear by the agency’s statement that it “encourages national banks to adopt policies and procedures to address, and in practice to avoid, engaging in loan practices that may be abusive, unfair or deceptive.”

Federal officials recognize that the explosive growth in subprime mortgage loans over the past decade has led to a significant increase in predatory lending abuses. Subprime mortgage originations “grew by a factor of seven over the 1994–2002 period” and reached $241 billion in 2002, representing almost one-tenth of the total home mortgage market. Regulators and industry analysts agree that predatory lending practices occur most frequently in the subprime lending market. Those predatory lending practices include: (i) loan flipping (i.e., frequent refinancing of high-cost home loans); (ii) equity stripping (i.e., the loss of equity resulting from repeated refinancing

323 12 U.S.C. § 371(a) (requiring real estate loans by national banks to comply with “such restrictions and requirements as the [OCC] may prescribe by regulation or order”) (emphasis added); see also 1 Richard J. Pierce, Jr., Administrative Law Treatise §§ 6.3, 8.1 (4th ed. 2002) (explaining that federal agency “rules” and “orders” have legally binding effect, in contrast to non-binding statements of policy).

324 OCC AL 2003-2, supra note 322, at 1, 2 (emphasis added).

325 Id. at 9 (emphasis added); see also OCC AL 2003-3, supra note 322, at 2 (stating that “this advisory letter provides specific recommendations for accomplishing these objectives”) (emphasis added).


that requires the borrower to pay high fees and closing costs); (iii) asset-based lending (i.e., the extension of credit based primarily on the residual value of the borrower’s home and other personal assets without regard to the borrower’s income); (iv) excessive fees and penalty charges; (v) high-pressure sales tactics accompanied by inadequate or misleading disclosures; and (vi) aggressive foreclosure policies.\(^{328}\)

The OCC has condemned “abusive” lending practices that “take unfair advantage of borrowers, . . . have a detrimental impact on communities,” or “involve unfair and deceptive conduct.”\(^{329}\) The OCC’s recent advisory letters warn national banks that they should follow policies that avoid the risks of making loans with “features or circumstances that have been associated with abusive lending practices, including the following: . . . [s]ingle-premium credit life insurance or other products; . . . [f]inancing points, fees, penalties, and other charges; [and] interest rate increases upon default.”\(^{330}\) The advisory letters point out that these “abusive lending practices” have often been used to accomplish predatory lending strategies such as loan flipping and equity stripping.\(^{331}\) In addition, the OCC’s advisory letters admonish national banks about the risks of making loans with “features or circumstances that have been associated with abusive

\(^{328}\) See Engel & McCoy, Three Markets, supra note 327, at 1280–86, 1293–94, 1297–98; Gramlich Predatory Lending Speech, supra note 327, at 2–3; GAO Predatory Lending Report, supra note 326, at 18–22, 99–102; HUD-Treasury Report, supra note 326, at 2–9, 17–22, 73–78, 89–100. The chair of the Coalition for Fair and Affordable Lending, a trade association of mortgage lenders, recently acknowledged that:

Unfair and abusive practices do occur in the nonprime mortgage market, and they must be stopped. Many such abuses, typically referred to as “predatory lending,” involve fraud and other conduct already prohibited by law. Tougher enforcement is clearly needed, as are better financial education and counseling programs. However, other questionable practices are not adequately regulated, and new legislative safeguards are needed.


\(^{329}\) OCC AL 2003-2, supra note 322, at 1. In the preamble to its final preemption rules, the OCC acknowledged that “predatory and abusive lending practices are inconsistent with national objectives of encouraging home ownership and community revitalization, and can be devastating to individuals, families and communities.” OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1913.

\(^{330}\) Id. at 8; see also OCC AL 2003-3, supra note 322, at 7.

\(^{331}\) See OCC AL 2003-2, supra note 322, at 2-6; OCC AL 2003-3, supra note 322, at 2-5.
lending practices, including the following: . . . [n]egative amortization; [b]alloon payments in short-term transactions; [p]ayment penalties that are not limited to the early years of a loan; [f]inancing points, fees, penalties, and other charges; [and] [i]nterest rate increases upon default.” 332 The advisory letters also acknowledge that many borrowers do not receive adequate disclosures and do not possess enough sophistication to understand the risks inherent in home loans that carry high interest rates and costly fee structures. 333

Thus, the OCC’s advisory letters expressly acknowledge the threat that predatory lending poses to consumers, especially lower-income borrowers who do not possess a high degree of sophistication in financial matters. Nevertheless, the OCC has declined to adopt mandatory regulations to prevent predatory lending except for a single rule that bars national banks from making real estate loans based “predominantly” on the expected foreclosure or liquidation value of the borrowers’ collateral. 334

Since the OCC has largely declined to adopt mandatory standards to stop predatory lending, the OCC cannot point to any actual conflict between its precatory “supervisory guidance” and state predatory lending laws that do impose binding rules. Accordingly, the OCC has no reasonable basis under § 371(a) to preempt state laws that apply evenhandedly to all real estate lenders and are reasonably calculated to prevent the same types of predatory lending practices the OCC itself has condemned. 335 Indeed, two recent studies conclude that North

332 OCC AL 2003-2, supra note 322, at 8; see also OCC AL 2003-3, supra note 322, at 7.
333 See OCC AL 2003-2, supra note 322, at 2-8; OCC AL 2003-3, supra note 322, at 2-5; see also HUD-TREASURY REPORT, supra note 326, at 2-9, 17-22, 62-68, 73-78, 89-100. The HUD-Treasury Report found that prospective borrowers considering subprime, high-cost home loans would benefit greatly from “pre-transaction counseling,” because “[t]estimony . . . from borrowers who received abusive loans revealed that, in almost every case, the borrower did not understand all the terms of the loan.” Id. at 57-62 (quoting at 60). However, some analysts have questioned the potential effectiveness of pre-transaction counseling, given the complex terms of most subprime loans and the relative lack of sophistication of many subprime borrowers. See Engel & McCoy, Three Markets, supra note 327, at 1285-86, 1309-11; GAO PREDATORY LENDING REPORT, supra note 326, at 13–14, 94–98.
334 See supra notes 317–25 and accompanying text.
335 See infra notes 337–42, 403–05 and accompanying text (citing federal statutes and cases that affirm the states’ authority to enact laws prohibiting mortgage lenders from engaging in predatory lending and other unconscionable lending practices); see also GAO PREDATORY LENDING REPORT, supra note 326, at 58–67 (reporting that as of Jan. 9, 2004, twenty-five states and the District of Columbia had adopted laws addressing predatory lending practices).
Carolina’s predatory lending statute, enacted in 1999, has been effective in reducing the incidence of abusive subprime lending practices in that state.336

Two federal statutes support the application of state predatory lending laws to national banks. As the OCC recognizes, national banks engaging in abusive practices associated with high-cost home loans are likely to violate the Home Ownership and Equity Protection Act (“HOEPA”)337 and section 5 of the Federal Trade Commission Act (“FTC Act”).338 Significantly, both HOEPA and section 5 of the FTC Act permit the states to enact their own laws to prevent predatory lending practices. HOEPA preserves the right of each state to enact supplemental laws governing fees, charges, and other terms of home mortgages as long as such laws do not conflict with HOEPA’s provisions.339 Similarly, the courts have held that section 5 of the FTC

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336 See Richard Cowden, Researchers Find North Carolina Law Has Reduced Certain Lending Practices, 80 Banking Rep. 892 (BNA) (June 2, 2003) (reporting on Walter R. Davis’s oral presentation of a study that concluded that North Carolina’s statute reduced the frequency of “subprime lending practices that have been criticized as constituting predatory lending”); Gramlich Predatory Lending Speech, supra note 326, at 5 (discussing results of the same study and a second recent study, both of which concluded that North Carolina’s statute (i) has resulted in “a reduced presence of [subprime] credit with abusive terms” and (ii) “has been effective in deterring lenders who use predatory practices”). The OCC has criticized certain aspects of the data used in the first study. See OCC Docket 03-17, supra note 26, 68 Fed. Reg. at 46,271 n.26 (discussing study co-authored by Walter R. Davis, Roberto G. Quercia, and Michael A. Stegman).


339 15 U.S.C. § 1610(b). As Mr. Cayne and Ms. Perkins point out, the Seventh Circuit has held that HOEPA’s “savings clause” for state regulation (contained in 15 U.S.C. § 1610(b)) does not prevent state laws from being subject to potential preemption under the Alternative Mortgage Transaction Parity Act, 12 U.S.C. §§ 3801–3806 (“AMTPA”). See Cayne & Perkins, supra note 2, at 402–03 (citing Ill. Ass’n of Mortgage Brokers v. Office of Banks and Real Estate, 308 F.3d 762 (7th Cir. 2002)). However, the Seventh Circuit’s decision does not foreclose the significance of HOEPA in defining the scope of the OCC’s authority to preempt state laws under the NBA. In Illinois Ass’n of Mortgage Brokers, the Seventh Circuit pointed out that AMTPA authorizes non-federally chartered housing creditors to enter into “alternative mortgage transactions” in accordance with “applicable” regulations of the OTS, “notwithstanding any State constitution, law, or regulation.” 308 F.3d at 766 (quoting 12 U.S.C. §§ 3802(1), 3803(c)). As the Seventh Circuit observed,
Act does not “occupy the field of consumer protection.” Therefore, the states may enact supplemental consumer protection laws—including protections in the area of home mortgage lending—as long as those laws do not conflict with the regulations of the Federal Trade Commission (“FTC”) under section 5. HOEPA and section 5 of the FTC Act provide additional evidence that (i) the OCC does not have authority to preempt state laws that are reasonably designed to prevent banks from engaging in predatory lending and (ii) the uniform real estate lending standards under 12 U.S.C. § 1828(o) incorporate applicable state laws when they instruct FDIC-insured institutions to act in “[c]ompliance with all real estate related laws and regulations.”

In § 1828(o) Congress instructed the federal banking agencies to adopt uniform standards for real estate lending that take account of (i) “the risk [that real estate loans present] to the deposit insurance funds” and (ii) “the need for safe and sound operation of insured depository institutions.” Subprime lending has proven to be a very risky business. Subprime loans entail a much higher risk of default, and subprime lending is frequently combined with hazardous securitization techniques. The four most costly bank failures since 1997—resulting in total losses to the FDIC of $1.7 billion—involved...

“Nothing could be clearer . . . . § 3803(c) is as express as a preemption clause gets.” Id. In contrast to AMTPA’s unambiguous grant of preemptive rulemaking power to the OTS, the NBA does not give any comparable authority to the OCC. As shown above in Parts III.B.4 and III.E.1, the OCC does not have power under 12 U.S.C. §§ 93a and 371(a) to adopt rules giving national banks a general immunity from state regulation. In fact, the OCC’s rulemaking power under § 371(a) with respect to real estate loans is expressly limited by the uniform interagency standards established under 12 U.S.C. § 1828(o). As previously noted, those interagency standards require national banks to observe “all real estate related laws and regulations,” a phrase that on its face incorporates HOEPA (including HOEPA’s savings clause for state regulation contained in 15 U.S.C. § 1610(b)). See supra notes 286–95 and accompanying text.


See 12 C.F.R. pt. 34 subpt. D app. A; see also supra note 290 and accompanying text (quoting the foregoing provision of the interagency uniform standards on real estate lending); supra notes 286–95 and accompanying text (describing the limits imposed by § 1828(o) on the OCC’s rulemaking authority under § 371(a)).

institutions heavily engaged in subprime lending and securitization. Federal agencies chartered three of the four failed institutions—First National Bank of Keystone and Nextbank were chartered by the OCC and Superior Bank, FSB was chartered by the OTS. After reviewing the four failures, government officials determined that subprime lending and securitization present a high degree of risk to federal deposit insurance funds. Officials also concluded that federal supervision of the four failed banks was inadequate and, in each case, did not identify the risk of failure in a timely manner.


A recent FDIC staff study concluded that the FDIC suffered $1.7 billion of estimated losses as a result of these four bank failures. Those losses accounted for eighty percent of the FDIC’s total losses from bank failures occurring during 1997–2002. See Richard Salmon et al., Costs Associated with Bank Failures, Oct. 10, 2003, at 1, 7 (tbl. 3), 9–12, available at http://www.swgsb.org/fdic/fdic3.pdf (staff study of thirty-four bank failures occurring during 1997–2002, prepared by the FDIC’s Division of Resolutions and Receiverships).

345 See FDIC-OIG Superior Bank Report, supra note 344; GAO Superior Bank Report, supra note 344; Treasury-OIG Keystone Report, supra note 344; Treasury Superbank Report, supra note 344; Treasury Nextbank Report, supra note 344. The fourth major failure of a bank that was heavily involved in subprime lending was BestBank, a Colorado state-chartered, FDIC-insured bank that failed in 1998. See FDIC-OIG BestBank Report, supra note 344.


347 FDIC-OIG BestBank Report, supra note 344; FDIC-OIG Superior Bank Report, supra note 344; GAO Superior Bank Report, supra note 344; Treasury-OIG Keystone
An institution engaging in predatory lending is likely to confront a significantly higher risk of litigation, defaults, and losses from its subprime loans. For example, many borrowers who obtained subprime mortgage loans from Superior Bank subsequently filed lawsuits alleging predatory lending practices. Superior Bank’s failure was due in part to high rates of delinquency and default on its subprime loans. Accordingly, state predatory lending laws benefit the banking system by (i) discouraging subprime loans involving excessive default risks and (ii) advancing the congressional purposes of protecting the deposit insurance funds and promoting safe and sound lending, as mandated by § 1828(o)(2)(A). The OCC has no authority under § 371(a) to override state laws whose application to national banks is consistent with § 1828(o).

In the preamble to its recent preemption rules, the OCC stated that “we have no reason to believe that [predatory lending] practices are occurring in the national banking system to any significant degree.” The accuracy of that statement is open to serious question. Currently, most of the largest subprime mortgage lenders are nonbank affiliates of major bank holding companies. Citigroup became the largest subprime lender in the nation when it acquired Associates First Capital in 2000, and Citigroup agreed to acquire another large subprime lending unit in November 2003. Allegations of illegal or abusive

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350 See supra notes 287–90, 294–95 and accompanying text.

351 OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1914. Despite this statement, the OCC reported that since June 2000 it had taken enforcement actions against several national banks “to address unfair or deceptive [lending] practices and consumer harm.” *Id.*


353 See Wilmarth, *Transformation*, supra note 139, at 393, 402 (discussing Citig-
subprime lending practices have been filed against Bank of America, Bank One, Chase, Citibank, Fleet Bank, National City Bank, and Wells Fargo or against their affiliates. In 2002, Citigroup paid $240 million to settle claims of predatory lending filed against Associates First Capital by the FTC and consumers. Two years earlier, Providian National Bank, a large credit card bank, paid $300 million to settle allegations of predatory lending conduct. The foregoing evidence indicates that (i) national banks are engaged to a very significant degree, both directly and through their affiliates, in making and securitizing subprime loans, and (ii) a number of those subprime lending programs have produced serious allegations of abusive lending practices.

354 See Engel & McCoy, CRA Implications, supra note 348, at 189–91 (discussing allegations against FleetBoston ("Fleet") and Citigroup); Engel & McCoy, Three Markets, supra note 327, at 1296 (discussing allegations against a subsidiary of Citigroup); GAO Predatory Lending Report, supra note 326, at 37–38, 106 (app. I) (describing FTC enforcement actions against Citigroup as successor to Associates and against Fleet); Comments of the National Consumer Law Center et al. to the OCC, filed in OCC Docket 03-16, supra note 1 [hereinafter NCLC Comments], available at http://www.nclc.org/initiatives, pt. II.A. (listing more than twenty court cases filed against national banks or their affiliates, alleging "illegal or predatory lending activities"); Congressional Review of OCC Preemption: Hearing Before the Subcomm. on Oversight and Investigations, 108th Cong. 13-18 (2004) (testimony of Diana L. Taylor, N.Y. Superintendent of Banks) [hereinafter Testimony of Diana L. Taylor] (describing allegations of abusive or predatory lending practices filed against Fleet and several other national banks or their affiliates).

355 See Rob Blackwell, Citi Execs on FTC Settlement: It's Not About Golden State, AM. BANKER, Sept. 20, 2002, at 1 (reporting that Citigroup had paid (i) $215 million to settle predatory lending claims filed by the FTC against Associates, arising out of loans made by Associates prior to its acquisition by Citigroup, and (ii) an additional $25 million to settle similar claims asserted in a class-action lawsuit).

The states have acted vigorously in enforcing predatory lending laws. State officials participated in the predatory lending investigations that produced large settlements with Providian and First Alliance.\(^{357}\) State officials also obtained a settlement requiring Household International to pay nearly $500 million, the largest settlement ever secured in a consumer-lending investigation.\(^{358}\) 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.\(^{359}\) The foregoing state enforcement efforts indicate that the states are taking reasonable and effective measures to stop predatory lending. Unfortunately, as discussed below in Part III.H.2, the OCC’s preemption and visitorial powers rules seriously impair the ability of state officials to protect consumers against abusive lending practices occurring at national banks and their operating subsidiaries.

F. The OCC Has No Authority to Implement a General Preemption of State Laws with Regard to the Deposits, Loans, and Operations of National Banks

Sections 7.4007 to 7.4009 of the OCC’s rules broadly preempt the application of state laws to national banks in the areas of (i) accepting deposits, (ii) making loans that are not secured by real estate, and

\(^{357}\) Kulish, supra note 356, at B12 (reporting that the San Francisco district attorney’s office and Connecticut’s attorney general took part in the investigations and settlements related to Providian’s allegedly unfair and deceptive practices); Paul Beckett, First Alliance Agrees To Large Settlement on Predatory Loans, WALL ST. J., Mar. 22, 2002, at A6 (reporting that First Alliance Mortgage agreed to pay $60 million in a settlement with the FTC and several states). A former senior executive in the credit card industry recently stated that “[a] California prosecutor . . . 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.” Duncan A. MacDonald, Letters to the Editor, Comptroller Has Duty to Clean Up Card Pricing Mess, AM. BANKER, Nov. 21, 2003, at 17 (letter from former general counsel of Citigroup’s European and North American credit card businesses).

\(^{358}\) See Paul Beckett & Joseph T. Hallinan, Household May Pay $500 Million Over ‘Predatory’ Loan Practices, WALL ST. J., Oct. 11, 2002, at A1 (reporting that Household agreed to pay almost $500 million to settle predatory lending claims presented by more than a dozen states); Portanger et al., supra note 353, at A10 (discussing Household settlement); see also GAO Predatory Lending Report, supra note 326, at 10, 62–63, 106–07 (app. I) (describing enforcement actions taken by state officials to combat predatory lending).

(iii) engaging in other activities authorized under federal law. In these three areas, national banks are now subject only to a narrow subset of state laws that “incidentally affect” their operations.\(^{360}\) Even this subset of state laws will not be deemed “incidental” and will be preempted if they “regulate the manner or content of the business of banking authorized for national banks.”\(^{361}\) Thus, only helpful state laws that “establish the legal infrastructure that makes practicable the conduct of [the banking] business” will apply to national banks in the areas of deposit-taking, unsecured lending and other “activities.”\(^{362}\)

The OCC claims that, under 12 U.S.C. §§ 24(Seventh) and 93a, it has power to adopt preemptive rules comparable to the OTS’s regulations that override state laws.\(^{363}\) However, as shown below, the OCC clearly lacks authority under those statutes to adopt §§ 7.4007 through 7.4009.

1. Sections 24(Seventh) and 93a Do Not Empower the OCC to Adopt §§ 7.4007–7.4009

As shown in Parts III.A and III.B.3, state laws apply to the contracts and dealings of national banks, including their deposit-taking and lending activities, unless such laws discriminate against national banks or create an impermissible conflict with federal law. In Luckett, for example, the Supreme Court declared:

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 . . . . Thus, the 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. . . .

As we have seen, a bank account is a chose in action of the depositor against the bank, which the latter is obligated to pay in accordance with the terms of the deposit. It is a part of the mass of property within the state whose transfer and devolution is subject to state control

\(^{360}\) See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1916–17 (text of 12 C.F.R. §§ 7.4007–7.4009). State laws that could be deemed “incidental” would include those dealing with contracts, torts, criminal law, rights to collect debts, acquisition and transfer of property, taxation, and zoning. Id. (text of 12 C.F.R. §§ 7.4007(c), 7.4008(d), 7.4009(c)(2)).

\(^{361}\) Id. at 1913.

\(^{362}\) Id.

\(^{363}\) Id. at 1907, 1914; OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,129 n.91.
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.\textsuperscript{364}

Similarly, in \textit{McClellan} the Supreme Court held that national banks must comply with a Massachusetts statute that barred creditors from accepting preferential transfers of property from insolvent debtors.\textsuperscript{365} The Court upheld the state law because (i) there was “no express conflict” between the state statute and federal law and (ii) “[n]o function of [national] banks is destroyed or hampered by allowing the banks to take real estate, provided only they do so under the same conditions and restrictions to which all other citizens of the State are subjected.”\textsuperscript{366}

Two courts specifically rejected the notion that § 24(Seventh) of the NBA mandates a general preemption of state laws affecting the deposit-taking activities of national banks. In \textit{Perdue}, for example, the California Supreme Court held:

There is no comprehensive federal statutory scheme governing the taking of deposits. There is one relevant statute, section 24 of the [NBA], and that merely authorizes banks to accept deposits. Section 24 may by implication also authorize banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits, but such implied authority does not constitute a regulatory scheme so comprehensive as to displace state law.\textsuperscript{367}

As the decision in \textit{Perdue} also noted, the U.S. Supreme Court struck down state laws affecting the deposits of national banks only in cases where such laws discriminated against, or otherwise significantly interfered with, the ability of national banks to accept deposits.\textsuperscript{368}

\textsuperscript{364} Anderson Nat’l Bank v. Luckett, 321 U.S. 233, 248 (1944) (citations omitted); \textit{see supra} notes 101–05 and accompanying text (discussing Luckett).

\textsuperscript{365} McClellan v. Chipman, 164 U.S. 347 (1896).

\textsuperscript{366} \textit{Id.} at 358.


The conference report on the Riegle-Neal Act demonstrates Congress’s clear understanding that the OCC does not have authority to implement any broad-scale preemption of state laws. As discussed in Part III.B.3, the conference report endorsed “well-established judicial principles” holding that (i) “national banks are subject to State law in many significant respects” and (ii) a “rule of construction” should be used that “avoids finding a conflict between the Federal and State law where possible.” The conference report also criticized two interpretive rulings in which the OCC asserted that state laws did not apply to the deposit-taking activities of national banks. The conference report declared that these rulings were “inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result.”

In response to the criticism of the Riegle-Neal conferees, the OCC rescinded an interpretive rule (former 12 C.F.R. § 7.8000) that purported to preempt all state laws affecting deposit account service charges assessed by national banks. In the 1996 rulemaking notice that rescinded § 7.8000, the OCC acknowledged the finding of the Riegle-Neal conferees that:

the OCC had applied preemption principles in an overly broad manner with respect to state laws that prohibit, limit, or restrict deposit account service charges imposed by a national bank. In addition, the conference report cited [Perdue], which held that § 7.8000 is not a valid finding of Federal preemption, in part, because Congress had not established a comprehensive Federal statutory scheme governing the taking of deposits.

As the OCC conceded, the court in Perdue held that § 7.8000 was “not a reasonable interpretation of the controlling [federal] statutes.” In fact, the court declared that the OCC’s blanket claim of

370 Id. at 53–54.
371 In place of the rescinded rule the OCC adopted 12 C.F.R. § 7.4002 (2003), under which the OCC decides preemption issues in the area of service charges “on a case-by-case basis” in accordance with “preemption principles derived from the Supremacy Clause of the United States and judicial precedent.” Interpretive Rulings, 61 Fed. Reg. 4849, 4859 (1996) (announcing the rescission of former § 7.8000 and the adoption of § 7.4002).
373 Perdue, 702 P.2d at 523.
preemption in § 7.8000 represented “legislation of far-reaching character and effect, of a type never considered by Congress, which would radically alter the respective roles of the states and the [OCC] in the regulation of bank-depositor contracts.”\textsuperscript{374} The court concluded that the OCC had no authority “to construe very general language in [12 U.S.C. § ] 24 to achieve a specific purpose not within the contemplation of Congress.”\textsuperscript{375}

In response to the conference report on the Riegle-Neal Act and the decision in \textit{Perdue}, the OCC admitted in 1996 that it did not have authority under the NBA to mandate a general preemption of state laws in the area of deposit account service charges. This admission confirms that the OCC lacked authority to adopt § 7.4007 because that rule has a far broader preemptive scope than rescinded § 7.8000. The rescinded rule applied only to deposit account service charges, while § 7.4007 creates a rule of de facto field preemption for all other matters related to the deposit-taking activities of national banks.\textsuperscript{376}

Similarly, the \textit{Kentucky}, \textit{McClellan}, and \textit{Long} decisions preclude the OCC from adopting proposed §§ 7.4008 and 7.4009. In \textit{Kentucky} the Supreme Court declared that:

[national banks] 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.\textsuperscript{377}

In \textit{McClellan} the Supreme Court observed that “in the broadest sense, any limitation by a State on the making of contracts is a restraint upon the power of a national bank [doing business] in the State.”\textsuperscript{378} However, the Court rejected the plaintiff’s argument that national banks “are entirely removed, as to all their contracts, from any and every control by the state law.”\textsuperscript{379} Instead, the Court declared that

\textsuperscript{374} Id.
\textsuperscript{375} Id. at 523 n.41.
\textsuperscript{376} See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1916 n.4 (text of 12 C.F.R. § 7.4007(b)(2)(vii) n.4, clarifying that “[s]tate laws purporting to regulate national bank fees and charges are addressed in 12 CFR 7.4002” and are not governed by § 7.4007).
\textsuperscript{378} McClellan v. Chipman, 164 U.S. 347, 358 (1896).
\textsuperscript{379} Id. at 359.
it was “long since settled” in *National Bank v. Kentucky* and other decisions that:

the purpose and object of Congress in enacting the national bank law was to leave [national] banks as to their contracts in general under the operation of the state law, and thereby invest them as Federal agencies with local strength, whilst, at the same time, preserving them from undue state interference wherever Congress . . . has expressly so directed, or wherever such state interference frustrates the lawful purpose of Congress or impairs the efficiency of the banks to discharge the duties imposed upon them by the law of the United States.  

In *Long* the Third Circuit held, in accordance with *Kentucky* and *McClellan*, that state laws apply to the lending activities and other operations of national banks unless there is an irreconcilable conflict with federal law.  

In view of these decisions and the specific admonitions of the conference report on the Riegle-Neal Act, the OCC had no authority to adopt de facto field preemption rules contained in §§ 7.4008 and 7.4009.

As shown in Part III.B.4, § 93a does not give the OCC any independent authority to adopt rules that would expand the congressionally-authorized powers and immunities of national banks by preempting state laws. Indeed, Comptroller Hawke acknowledged that the OCC has no “self-executing power to preempt state law.” Accordingly, § 93a does not provide any justification for the blanket preemption rules contained in §§ 7.4007 through 7.4009.

2. The OCC Does Not Possess a Preemptive Rulemaking Power Similar to the OTS’s Authority under 12 U.S.C. § 1464(a)

The OCC is also wrong in asserting that it enjoys a preemptive rulemaking power equivalent to that of the OTS. Under section 5(a) of HOLA, 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.” As previously

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380 *Id.* at 358–59.
383 See *supra* notes 5, 27–29 and accompanying text (discussing the OCC’s claim that its authority to adopt preemptive rules is equal to that of the OTS).
discussed, the Supreme Court held in *Fidelity Federal Savings and Loan Ass’n v. de la Cuesta*\(^{385}\) that section 5(a) conferred upon the OTS’s predecessor agency “plenary authority to issue regulations governing federal savings and loans,” an authority that “expressly contemplated . . . the [agency’s] promulgation of regulations superseding state law.”\(^{386}\)

The NBA does not give the OCC any “plenary” power to adopt preemptive rules comparable to the authority possessed by the OTS under section 5(a) of HOLA. The only sources of rulemaking authority cited by the OCC in adopting its preemption rules are §§ 371(a) and 93a.\(^{387}\) As demonstrated in Part III.E.1, the OCC has only limited power to promulgate rules for real estate lending under § 371(a), and the OCC’s power in that area is expressly subject to the uniform interagency standards established under § 1828(o). Those uniform standards require national banks to comply with “all real estate related laws and regulations,” a phrase that on its face includes applicable state laws.\(^{388}\) As shown in Part III.B.4, § 93a does not allow the OCC to expand the powers or immunities of national banks by adopting rules that preempt state laws unless the OCC can show an independent statutory mandate for its action that exists outside § 93a.

The courts have not resolved the question of whether the OTS possesses unlimited “field preemption” authority under section 5(a).\(^{389}\) Whatever the precise scope of the OTS’s authority under HOLA, the courts have consistently held that the OTS’s 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 Ass’n*\(^{390}\) the district court held that HOLA authorized the OTS’s predecessor 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.”\(^{391}\) The court also declared that the preemptive reach of HOLA is far greater than that of the NBA:

\(^{385}\) 458 U.S. 141 (1982).

\(^{386}\) *Id.* at 160, 162; *see also supra* notes 220–24 and accompanying text (discussing de la Cuesta).


\(^{388}\) *See supra* notes 287–95 and accompanying text (analyzing the OCC’s limited authority to issue rules for real estate lending under § 371).

\(^{389}\) *See supra* notes 223, 232–36 and accompanying text.


\(^{391}\) *Id.* at 316.
[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 [OTS’s predecessor] to organize, incorporate, supervise and regulate, leaving no room for state supervision.\textsuperscript{392}

This statement in \textit{Coast Federal} is significant because subsequent court decisions have quoted \textit{Coast Federal}’s “cradle-to-grave” metaphor in describing the expansive authority held by the OTS and its predecessor.\textsuperscript{393}

Similarly, in \textit{North Arlington National Bank v. Kearny Federal Savings \\& Loan Ass’n},\textsuperscript{394} the court held that the NBA could not be used as an “analogy” in discussing the authority granted to the OTS’s predecessor 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.”\textsuperscript{395} Two other federal appeals court decisions establish the same clear distinction between the broad preemptive authority of the OTS and the much more circumscribed power of the OCC.\textsuperscript{396}

In light of the foregoing judicial

\textsuperscript{392} Id. at 319 (citation and internal quotation marks omitted, emphasis added).


\textsuperscript{394} 187 F.2d 564 (3d Cir.), \textit{cert. denied}, 342 U.S. 816 (1951).

\textsuperscript{395} Id. at 567 (emphasis added).

\textsuperscript{396} See \textit{Bank of Am.}, 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”); Nat’l State Bank v. Long, 630 F.2d 981, 989 (3d Cir. 1980) (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”).

Notwithstanding the judicial authorities discussed in this Part III.F.2, Mr. Cayne and Ms. Perkins contend that the OCC’s preemptive rulemaking authority is “similarly broad” to that of the OTS. Cayne \\& Perkins, \textit{supra} note 2, at 397. This argument fails to recognize the crucial differences between the statutory grants of power made by Congress to the OTS and those made to the OCC. As discussed above, section 5(a) of HOLA authorizes the OTS to adopt rules providing for the “operation” and “regulation” of federal savings associations in accordance with what the OTS
authorities, the OCC cannot defend its preemption rules by referring to the OTS’s rulemaking power under HOLA.

G. The OCC’s Attempt to Bar States From Regulating Operating Subsidiaries of National Banks Is Unlawful

1. The OCC’s Proposal Violates Fundamental Principles of Financial Regulation and Corporate Governance

The OCC’s new preemption and visitorial powers rules, working in tandem with § 7.4006 of its existing rules, give operating subsidiaries of national banks a blanket immunity from state laws that impose licensing, examination, and other regulatory requirements on providers of financial services.397 The OCC’s new regime for operating subsidiaries is clearly unlawful because it disregards the unquestioned primacy of the states in regulating state-chartered corporations, as well as the states’ traditional role in supervising financial institutions. The courts have repeatedly upheld the authority of each state to (i) exercise comprehensive supervision over the corporations it charters, (ii) regulate corporations chartered by other states that transact business within its borders, and (iii) regulate entities that offer financial services to its residents. Regarding locally-chartered companies, 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.

. . . .

determines to be the “best practices of thrift institutions in the United States.” 12 U.S.C. § 1464(a) (2000); see also supra notes 221–22, 385–86 and accompanying text. In de la Cuesta, the Supreme Court placed great weight on this “best practices” language in deciding that the OTS’s predecessor agency had “broad authority” to “promulgate[. . .] regulations superseding state law.” 458 U.S. at 161–62. 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 shown in Parts III.B.4 and III.E.1, the OCC possesses only narrow grants of rulemaking power under 12 U.S.C. §§ 93a and 371(a).

397 See supra notes 1–13, 19–32 and accompanying text. The OCC’s preemption and visitorial powers rules did not make any changes to 12 C.F.R. § 7.4006. The OCC explained that, by virtue of the existing provisions of § 7.4006, the new preemption and visitorial powers rules for national banks would apply automatically to their operating subsidiaries. See OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1905, 1913; OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900.
State 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.\textsuperscript{398} Almost a century earlier the Court declared that “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.”\textsuperscript{399}

Regarding corporations chartered by other states, the Supreme Court 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.”\textsuperscript{400} The Court therefore upheld the authority of states to license and regulate foreign corporations in accordance with the following guidelines:

In the absence of applicable federal regulation, a State may impose non-discriminatory regulations on those engaged in foreign commerce ‘for the purpose of insuring the public safety and convenience; . . . a license fee no larger in amount than is reasonably required to defray the expense of administering the regulations may be demanded.’\textsuperscript{401}

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.”\textsuperscript{402}

In the area of financial services, courts have affirmed the authority of each state to regulate banks and nonbank corporations for the legitimate purpose of protecting the state’s economy and its citizens

\textsuperscript{398} CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89, 91 (1987) (citing, inter alia, Trustees of Dartmouth College v. Woodward, 17 U.S. 518, 636 (1819)).
\textsuperscript{400} Union Brokerage Co. v. Jensen, 322 U.S. 202, 208 (1944).
\textsuperscript{401} Id. at 211–12 (quoting Sprout v. South Bend, 277 U.S. 163, 169 (1928)).
\textsuperscript{402} Business Roundtable v. SEC, 990 F.2d 406, 412 (D.C. Cir. 1990); accord Santa Fe Indus., 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.”).
from threats posed by unsound or fraudulent providers. In *Lewis v. BT Investment Managers, Inc.*, the Supreme Court said:

> 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 activities.

The Court also explained 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.”

In the field of mortgage lending, federal and state courts have upheld the authority of states to enforce laws designed to prevent lenders from engaging in fraud, predatory lending, redlining, and other unconscionable practices. Three recent decisions applied a presumption against preemption in determining that the Alternative Mortgage Transaction Parity Act (“AMTPA”) does not preempt the application of many state laws to “alternative mortgage transactions” entered into by

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404 *Id.* at 38; *accord* Northeast Bancorp, Inc. v. Bd. 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.”).

405 *BT Investment Managers*, 447 U.S. at 448–49. Under 12 U.S.C. § 1846(a), the Bank Holding Company Act reserves to each state the authority to regulate “companies, banks, bank holding companies, and subsidiaries thereof.” In *BT Investment*, the Supreme Court noted that the challenged Florida law was not preempted by any federal statute. 447 U.S. 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. *Id.* at 31–32, 35–37, 42–44.


408 AMTPA defines “alternative mortgage transactions” to include residential mortgage loans other than “traditional fixed-rate, fixed-term transactions.” 12 U.S.C. § 3802(1). Thus, mortgage loans with adjustable interest rates, balloon payment requirements or untraditional amortization terms (e.g., reverse equity mortgages) are treated as alternative mortgage transactions for purposes of AMTPA.
state-chartered mortgage lenders. All three decisions recognized that real estate transactions and consumer protection are areas traditionally regulated by the states. In view of the foregoing judicial precedents and congressional mandates, the OCC’s attempt to bar the states from regulating operating subsidiaries of national banks is demonstrably at odds with fundamental principles of federalism inherent in our systems of corporate law and financial regulation.

The OCC asserts that four federal statutes—12 U.S.C. §§ 484, 36(f)(1)(B), 24(Seventh), and 24a—give the OCC “exclusive visitorial authority over national banks and their operating subsidiaries except where Federal law provides otherwise.” Based on this claim of “exclusive” authority, the OCC maintains that “States are precluded from examining or requiring information from national banks or their operating subsidiaries or otherwise seeking to exercise visitorial powers with respect to national banks or their operating subsidiaries.” As demonstrated below, however, none of the four statutes supports the OCC’s claim.


410 OCC Interpretive Letter No. 957 from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, to Thomas A. Plant, Senior Vice President and Assistant General Counsel, National City Corp., at 2 (Jan. 27, 2003) [hereinafter OCC IL 957] (emphasis added); see also OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900–01.

411 OCC IL 957, supra note 410, at 2.
2. Sections 484 and 36(f) Do Not Preempt the States’ Authority to Enforce State Laws Against National Banks and Their Operating Subsidiaries

a. Sections 484 and 36(f) Permit State Officials to Sue in Federal and State Courts to Enforce State Laws Against National Banks

Section 484(a) provides:

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 text of § 484(a) “does not contain an explicit grant of exclusive regulatory or visitorial power over national banks to the OCC.”412 In addition, other provisions of federal law make clear that the OCC does not enjoy exclusive visitorial powers over national banks. For example, the FDIC has authority to make special examinations of national banks, and the FDIC may terminate a national bank’s deposit insurance.413 The FDIC can take additional enforcement actions against a national bank if the OCC fails to respond after receiving the FDIC’s request for such measures.414 Similarly, the Federal Reserve Board can require national banks that are subsidiaries of bank holding companies to furnish reports and submit to special examinations.415

412 First Union Nat’l Bank v. Burke, 48 F. Supp. 2d 132, 144 (D. Conn. 1999) (emphasis added); see also id. at 137 (providing that “the OCC is not explicitly referenced in Section 484”). The exercise of “visitorial powers” involves “the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting its business, and enforce an observance of its laws and regulations.” Id. at 144 (quoting First Nat’l Bank of Youngstown v. Hughes, 6 F. 737, 740 (C.C.N.D. Ohio 1881), appeal dismissed, 106 U.S. 523 (1883)); see also Guthrie v. Harkness, 199 U.S. 148, 159 (1905) (describing visitorial powers as being “a public right, existing in the State for the purpose of examining into the conduct of the corporation with a view to keeping it within its legal powers”). Thus, “visitorial powers” include the power to examine the books and records of a corporation and to take administrative action to enforce the laws applicable to that corporation. See Burke, 48 F. Supp. 2d at 143–46.
413 See 12 U.S.C. §§ 1818(a), 1820(b)(3).
414 Id. § 1818(t).
415 Id. § 1844(c)(1)–(2).
Section 484 does not allow state officials to examine or impose administrative enforcement measures (e.g., cease-and-desist orders) against national banks, except as provided in § 484(b) with respect to state unclaimed property or escheat laws.\footnote{16} However, § 484(a) expressly authorizes “the courts of justice” to exercise “visitorial powers” over national banks.\footnote{17} Based on this authority, since 1871 state officials and private parties have successfully sued in federal and state courts to obtain judicial remedies enforcing state laws against national banks.\footnote{18} For example, courts have issued subpoenas, writs of mandamus, and penalties to compel national banks to produce their records in compliance with state laws.\footnote{19} In addition, federal and state courts have upheld the right of state officials and private parties to obtain affirmative judicial remedies to enforce state laws against national banks.\footnote{20}

In interpreting the meaning of § 484, the terms of section 54 of the original NBA\footnote{21} are highly significant. Section 54 contained the predecessor language for both 12 U.S.C. §§ 481 and 484. Like § 481, section 54 of the original NBA authorized the OCC to examine national banks. After granting such examination authority, section 54 provided, “And [a national bank] shall not be subject to any other

\footnote{16}{Id. § 484. For cases holding that state officials cannot examine or take administrative enforcement actions against national banks, see Nat’l State Bank v. Long, 630 F.2d 981, 987–89 (3d Cir. 1980); First Union Nat’l Bank v. Burke, 48 F. Supp. 2d 132, 140, 143–50 (D. Conn. 1999).

\footnote{17}{12 U.S.C. § 484(a).


\footnote{19}{See, e.g., Guthrie, 199 U.S. at 150, 156, 159 (mandamus); Waite, 94 U.S. at 532–33 (penalty); First Nat’l Bank of Youngstown v. Hughes, 6 F. 737, 740–43 (C.C.N.D. Ohio 1881) (subpoena), appeal dismissed, 106 U.S. 523 (1883).

\footnote{20}{See, e.g., First Nat’l Bank in St. Louis, 263 U.S. at 659–61; Burke, 48 F. Supp. 2d at 145–46, 148–49, 150–51; Best, 739 P.2d at 563; see also Guthrie, 199 U.S. at 159 (holding that, under the predecessor to § 484, national banks were “liable to control in the courts of justice,” and, therefore, “the statute did not intend in withholding visitorial powers to take away the right to proceed in courts of justice to enforce . . . recognized rights”).

visitorial powers than such as are authorized by this act, *except* such as are vested in the several courts of law and chancery.” Thus, section 54 reflected Congress’s understanding that the term “visitorial powers” would include (i) examinations of national banks by the OCC and (ii) the exercise of judicial authority over national banks by “the several courts of law and chancery.”

The original NBA also made clear that *both federal courts and state courts* could exercise “visitorial powers” over national banks in appropriate cases. Section 57 provided that “suits, actions and proceedings against any association under this act may be had in any circuit, district, or territorial court of the United States held within the district in which such association may be established; or in any state, county or municipal court in the county or city in which said association is located, having jurisdiction in similar cases.” Section 57 included a proviso stating that “all proceedings to enjoin the [OCC] under this act” must be filed in federal courts. By negative implication this proviso made clear that judicial proceedings *against national banks* could be brought in either federal or state courts.

In accordance with the language of section 57, the Supreme Court upheld the jurisdiction of state courts to adjudicate claims filed against national banks. In *Morgan* the Supreme Court noted that the “exemption of national banking associations from suits in state courts, established elsewhere than in the county or city in which such associations were located, was . . . prescribed for the convenience of those institutions, and to prevent interruption in their business that might result from their books being sent to distant counties in obedience to process from state courts.” Thus, the Court explained, the venue provisions of section 57 were designed to shield national banks from subpoenas issued by “distant” state courts. At the same time the Court clearly recognized that *local* state courts were authorized under section 57 to issue subpoenas requiring national banks to produce their books and records.

The “visitorial powers” language of section 54 of the NBA was later incorporated in section 5241 of the Revised Statutes. Section 5241

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422 *Id.* (emphasis added).
423 *Id.* § 57, 13 Stat. 116–17 (emphasis added).
424 *Id.*, 13 Stat. 117.
426 *Morgan*, 132 U.S. at 145 (emphasis added).
stated that “[n]o association shall be subject to any visitorial powers other than such as are authorized by this Title, or are vested in the courts of justice.”

Thus, section 5241—like section 54 of the original NBA and current 12 U.S.C. § 484(a)—expressly affirmed the authority of “the courts of justice” to exercise “visitorial powers” over national banks. In St. Louis the defendant national bank and the United States (appearing as amicus curiae) asserted that section 5241 and other provisions of the NBA prohibited state officials from suing in state courts to enforce state laws against national banks. The Supreme Court, however, rejected those arguments. The Court held that state officials do not exercise prohibited “visitorial powers” when they bring judicial proceedings to stop national banks from violating state laws:

> What the State is seeking to do is to vindicate and enforce its own law, and the ultimate inquiry which it propounds is whether the [national] bank is violating that law, not whether it is complying with the charter or law of its creation. . . . Having determined that the power sought to be exercised by the [national] bank finds no justification in any law or authority of the United States, the way is open for the enforcement of the state statute. . . . The application of the state statute to the present case and the power of the State to enforce it being established, the nature of the remedy to be employed is a question for state determination.

Thus, St. Louis conclusively establishes the authority of state officials to obtain judicial remedies to enforce valid state laws against national banks. The OCC argues, however, that St. Louis permits a

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427 Rev. Stat. § 5241 (emphasis added).


429 First Nat’l Bank in St. Louis, 263 U.S. at 660–61 (emphasis added); accord First Union Nat’l Bank v. Burke, 48 F. Supp. 2d 132, 145–46, 148–49, 150–51 (D. Conn. 1999). Mr. Cayne and Ms. Perkins maintain that I have “ignore[d]” the significance of the statutory precursors to 12 U.S.C. § 484. Cayne & Perkins, supra note 2, at 375. They also contend that the “vested in the courts of justice” clause of § 484(a) has no relevance to the question of “[w]hether a lawsuit is properly brought against a national bank.” Id. at 382. Both of these claims are mistaken. As I have shown, § 484 and its precursors—sections 54 and 57 of the original NBA and § 5241 of the Revised Statutes—plainly authorized federal and state courts to entertain lawsuits brought by private parties and state officials seeking judicial remedies against national banks that refused to comply with state laws. See supra notes 417–28, infra notes 433–34 and accompanying text.
state official only “to seek a declaratory judgment from a court as to whether a particular state law applies to the Federally-authorized business of a national bank or is preempted.”

If the court holds that the state law is not preempted, the OCC claims that “enforcement of a national bank’s compliance with [that] law” is a matter “within the OCC’s exclusive purview.” Thus, in amending §7.4000 of its regulations the OCC asserted that it has sole and unreviewable discretion to decide whether to seek injunctive relief or other affirmative judicial remedies to prevent national banks from violating applicable state laws.

The OCC’s interpretation of St. Louis is clearly wrong. In the excerpt from St. Louis quoted above, the Supreme Court declared that “the nature of the remedy to be employed” to enforce a valid state law “is a question for state determination.” Moreover, in St. Louis the Supreme Court affirmed a state court judgment that granted prohibitory relief, requested by the Missouri Attorney General, to stop a national bank’s violation of Missouri law. In accordance with

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430 OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900.
431 Id.
432 See supra notes 6–13 and accompanying text.
433 St. Louis, 263 U.S. at 661 (emphasis added).
434 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 in the Missouri Supreme Court that “ousted [the national bank] from the privilege of operating this branch bank or any other.” 263 U.S. at 655, aff’d 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 of Missouri proceeded in quo warranto “to prevent [the national bank] from committing an act . . . 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”). In St. Louis, the United States Supreme Court cited an earlier decision in which it affirmed a Missouri Supreme Court judgment that awarded similar prohibitory relief in another quo warranto proceeding. In that earlier case, the Missouri court determined that two out-of-state corporations were guilty of price fixing and should be barred from doing business in the state. See 263 U.S. at 661 (citing Standard Oil of Ind. v. Missouri, 224 U.S. 270 (1912) (affirming judgment in quo warranto that revoked the defendants’ corporate franchises in Missouri and also imposed fines)); see also Sage Stores Co. v. Kansas ex rel. Mitchell, 323 U.S. 32 (1944) (affirming judgment in quo warranto that prohibited two corporations from selling “filled milk” in Kansas in violation of a state statute). The foregoing cases demonstrate, contrary to the OCC’s argument, that 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.
St. Louis, subsequent federal court decisions have repeatedly upheld the authority of state officials to obtain affirmative remedies—including injunctive relief—to prevent violations of state law by national banks.435 Thus, contrary to the OCC’s view, § 484(a) unquestionably allows state officials to obtain compulsory judicial remedies that directly enforce state laws against national banks.

In support of its claim of “exclusive visitorial authority,” the OCC also cites 12 U.S.C. § 36(f)(1)(B). Section 36(f)(1)(B) provides that host state laws applicable to interstate branches of national banks “shall be enforced” by the OCC.436 However, § 36(f)(1)(B) does not expressly bar state officials from suing in federal or state court to prohibit national bank branches from violating host state laws. The relevant legislative history shows that this provision was intended to provide the OCC with exclusive authority to perform examinations of, or to take administrative enforcement actions against, interstate branches of national banks.437

When § 36(f)(1)(B) is read together with § 484(a), it becomes clear that state officials retain the authority to obtain judicial remedies to enforce applicable host state laws against interstate branches of national banks. Judicial enforcement orders are a proper exercise of the “visitorial powers” that are expressly vested in “the courts of

435 See, e.g., Missouri ex rel. Kostman v. First Nat’l Bank in St. Louis, 405 F. Supp. 733, 735 (E.D. Mo. 1975) (holding, in reliance on St. Louis, that a state banking 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); 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) (affirming judgment in favor of the State of Colorado in a suit for declaratory and injunctive relief; declaratory judgment was issued based on the defendant national bank’s “assurances that it would follow the trial court’s declaratory judgment without the necessity of an injunction”); Brown v. Clarke, 878 F.2d 627 (2d Cir. 1989) (affirming judgment in favor of a state banking commissioner who “brought suit in federal court seeking relief that would bar” a national bank from violating state law).

Mr. Cayne and Ms. Perkins contend that “[i]none of the cases cited by Professor Wilmarth serves as a foundation for his argument about the ‘vested in the courts of justice’ clause in § 484.” Cayne & Perkins, supra note 2, at 382 n.72. However, they do not consider the obvious significance of St. Louis and Burke, discussed supra at notes 420, 428–29, 433–34 and accompanying text, and the additional cases cited in this footnote.


justice” under § 484(a) and are not excluded by the specific terms of § 36(f)(1)(B). In contrast, the OCC’s reading of § 36(f)(1)(B) would repeal a significant portion of § 484(a) because the OCC’s interpretation would prevent “the courts of justice” from exercising jurisdiction over suits filed by state officials to prohibit interstate branches of national banks from violating host state laws. Indeed, the OCC’s position would give the agency sole and unreviewable discretion to decide whether to enforce such laws. The OCC’s interpretation must be rejected, because there is no evidence that Congress intended (i) to repeal by implication a significant part of § 484(a) or (ii) to give the OCC an exclusive and unreviewable prosecutorial discretion to decide whether applicable host state laws should be enforced against national banks.438

In sum, the OCC acted unlawfully in amending § 7.4000 of its regulations to declare that § 484(a) bars state officials from seeking judicial remedies to enforce state laws against national banks. The amended rule conflicts with the explicit text of § 484(a) because it denies the authority of “the courts of justice” to exercise “visitorial powers” that are expressly “vested” in them under § 484(a). Those powers clearly include the right to exercise jurisdiction over lawsuits filed by state officials seeking affirmative judicial remedies to stop national banks from violating state laws.439

b. Sections 484 and 36(f) Do Not Restrict the Authority of State Officials to Enforce State Laws Against Operating Subsidiaries of National Banks

Sections 484 and 36(f) do not support the OCC’s claim that it possesses exclusive supervisory authority over operating subsidiaries of national banks. The limitations on visitorial powers under § 484(a) apply only to a “national bank.”440 Similarly, § 36(f)(1)(B) provides

438 See, e.g., Watt v. Alaska, 451 U.S. 259, 267 (1981) (holding that “repeals by implication are not favored ... [and the] intention of the legislature to repeal must be clear and manifest”; accordingly, “[w]e must read the statutes to give effect to each if we can do so while preserving their sense and purpose”) (citations and internal quotation marks omitted); Gutierrez de Martinez v. Lamagno, 515 U.S. 417, 424–26 (1995) (rejecting a proposed interpretation of a federal statute, because that interpretation would “attribute to Congress two highly anomalous commands” by (i) allowing an executive official to “make determinations” that are “dispositive” of a legal controversy “without any judicial check” and (ii) stripping the courts of their “capacity to evaluate independently whether the executive’s decision is correct”).

439 See supra notes 417–29, 433–35 and accompanying text.

that applicable host state laws shall be enforced by the OCC only with respect to a branch of an out-of-state national bank.\footnote{441} Thus, §§ 484(a) and 36(f)(1)(B) apply only to national banks and do not restrict the authority of state officials to use judicial or administrative proceedings to enforce state laws against 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 and 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,\footnote{442} (ii) receives from the OCC a certificate of authority to carry on the business of banking,\footnote{443} and (iii) is eligible to become a member of the Federal Reserve System (“FRS”).\footnote{444} Operating subsidiaries do not qualify as national banks under §§ 221 and 221a(a) because they (i) are chartered as non-bank corporations under state law, (ii) do not file articles of association or organization certificates with the OCC, (iii) do not receive certificates of authority to conduct the business of banking from the OCC, and (iv) cannot become members of the FRS.\footnote{445} Accordingly, operating subsidiaries cannot be treated as national banks for purposes of §§ 484 and 36(f) and are not entitled to any immunity from the exercise of state enforcement powers.

This analysis is supported by § 221a(b), which defines “affiliate” to include any corporation that controls or is controlled by a national bank.\footnote{446} An operating subsidiary is an “affiliate” because, under the

\begin{itemize}
\item \footnote{441} Id. § 36(f)(1)(B).
\item \footnote{442} See id. §§ 21–24, 26.
\item \footnote{443} See id. §§ 24, 27.
\item \footnote{444} See id. § 282.
\item \footnote{445} Pursuant to 12 U.S.C. §§ 21–24, 26–27, the OCC’s regulations provide: “A national bank becomes a legal entity after it has filed its organization certificate and articles of association with the OCC as required by law.” Also, “[t]he proposed bank shall not conduct the business of banking until the OCC grants final approval.” 12 C.F.R. § 5.20(i)(5) (2003). Under the OCC’s own regulations, it is obvious that an operating subsidiary cannot qualify for legal status as a national bank. First, an operating subsidiary cannot file an organization certificate or articles of association that would satisfy the requirements imposed on national banks under 12 U.S.C. §§ 21–23. Second, the OCC cannot give “final approval” to an operating subsidiary in the form of a certificate of authority to commence the business of banking, as is required for each national bank under § 27. Finally, an operating subsidiary is not eligible to become a member of the FRS, but every national bank must become an FRS member under § 282.
\item \footnote{446} 12 U.S.C. § 221a(b).
\end{itemize}
OCC’s regulations, the subsidiary must always be subject to the control of its parent national bank.447 As confirmed by the legislative history of § 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.448

Congress’s recognition of the separate legal status of an affiliate is confirmed by 12 U.S.C. § 481. Under § 481, the OCC may examine affiliates of a national bank to the extent “necessary to disclose fully the relations between such bank and such affiliates and the effect of such relations upon the affairs of such bank.”449 In contrast to § 481, Congress did not include the term “affiliates” in § 484. Accordingly, 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. The only reasonable conclusion is that § 481 does not restrict the

447 See 12 C.F.R. § 5.34(e)(1)–(2).

448 The definition of “affiliate” in § 221a(b) was added to the FRA 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. For the general background of the 1933 legislation, see, for example, Edwin J. Perkins, The Divorce of Commercial and Investment Banking: A History, 88 Banking L.J. 483 (1971).

states’ authority to regulate affiliates. Read together, §§ 481 and 484 plainly indicate that Congress has not preempted the authority of state officials to supervise operating subsidiaries of national banks.\textsuperscript{450}

Congress enacted 12 U.S.C. §§ 371c and 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.\textsuperscript{451} There was 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” that are separate and distinct from their parent banks under § 221a(b).\textsuperscript{452} The OCC’s current view that “operating subsidiaries and their parent banks [are] equivalents”\textsuperscript{453} is therefore untenable because the OCC’s position obliterates the careful distinction that Congress has drawn between national banks and their affiliates in § 221a, and it also reduces the special exemption for operating subsidiaries in §§ 371 and 371c-1 to the status of “meaningless . . . surplusage.”\textsuperscript{454}

\textsuperscript{450} Chicago v. Envtl. Def. Fund, 511 U.S. 328, 338 (1994) (holding that “[i]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another”) (internal quotations and citation omitted).


\textsuperscript{452} Indeed, as the OCC previously recognized, Congress would not have found it necessary to give operating subsidiaries a special exemption from the affiliate transaction provisions of §§ 371c and 371c-1—thereby permitting operating subsidiaries to be treated as part of their parent banks under those two statutes—unless Congress intended that operating subsidiaries should be treated differently from their parent banks under all other statutes. See 1997 OCC Zions Order, supra note 449, at *36 n.46 (observing that §§ 371c and 371c-1 “demonstrate that when Congress intended bank subsidiaries to be subject to the same standard as that applied to their parent bank, Congress knew how to say so”).

\textsuperscript{453} OCC Docket 03-16, supra note 1, 68 Fed. Reg. at 46,130; see also OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900 (arguing that operating subsidiaries should be treated as “incorporated departments of the [parent] bank itself”).

\textsuperscript{454} Indep. Ins. Agents of Am., Inc. v. Hawke, 211 F.3d 638, 643–44 (D.C. Cir. 2000) (rejecting an interpretation of 12 U.S.C. § 24(Seventh) that “would render at least two other related statutes meaningless, in violation of the endlessly reiterated principle of statutory construction . . . that all words in a statute are to be assigned meaning, and that nothing therein is to be construed as surplusage”) (citation and internal quotation marks omitted); see also Bd. of Governors v. Inv. Co. Inst., 450 U.S. 46, 58–59 n.24 (1981) (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 the Act that would cause one of its sections,
In the field of mortgage lending, the Alternative Mortgage Transaction Parity Act ("AMTPA") demonstrates Congress’s intent to regulate state-chartered non-bank lenders in an entirely different manner from federally-chartered banks. AMTPA recognizes that the OCC and other federal banking agencies “adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing.” AMTPA seeks to “prevent discrimination against State-chartered depository institutions and other nonfederally chartered housing creditors” by authorizing those state-chartered lenders to enter into alternative mortgage transactions. To accomplish this purpose, AMTPA authorizes (i) the OCC to adopt regulations permitting state-chartered banks to enter into alternative mortgage transactions, (ii) the National Credit Union Administration (“NCUA”) to adopt similar rules for state-chartered credit unions, and (iii) the OTS to adopt similar rules for all other state-chartered housing creditors, including non-bank lenders. State-chartered housing creditors may rely on authority granted by AMTPA only if those lenders comply with applicable “licensing requirements imposed under State law” as well as “applicable regulatory requirements and enforcement mechanisms provided by State law.”

After carefully reviewing the terms, structure, and purposes of AMTPA, three courts recently concluded that state-chartered, non-bank mortgage lenders do not receive the same exemption from state law that federally-chartered banks receive under OCC and OTS regulations. All three courts determined that AMTPA ensures the ability of state-chartered non-bank lenders to engage in the business of alternative mortgage financing. However, these courts found that AMTPA does not establish competitive equality or absolute parity between federally-chartered banks and state-chartered, non-bank lenders dealing with “affiliates,” to become “meaningless”); see also Am. Textile Mfrs. Inst., Inc. v. Donovan, 452 U.S. 490, 513 (1981) (rejecting a proposed interpretation that would render 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”).


Id. § 3803(a).

Id. § 3803(a)(1)–(3); see Nat’l Home Equity Mortgage Ass’n v. OTS, 271 F. Supp. 2d 264, 274 (D.D.C. 2003) (noting that under AMTPA, “while OCC identifies regulations for state-commercial banks, and NCUA does so for state-chartered credit unions, OTS identifies regulations for all other state-chartered housing creditors”).

lenders because AMTPA does not exempt the latter group from state laws such as licensing requirements and other regulations designed to protect consumers.\footnote{460}{See NHEMA v. OTS, 271 F. Supp. 2d at 271–73, 277; Black, 112 Cal. Rptr. 2d at 453–58; Glukowsky v. Equity One, Inc., 821 A.2d 485, 507–10 (N.J. Super. Ct. App. Div. 2003).}

Thus, AMTPA provides strong evidence of Congress’s intent to preserve the states’ authority to regulate state-chartered non-bank lenders in the field of mortgage lending. In particular, 12 U.S.C. § 3802(2) undermines the OCC’s position that state-chartered non-bank mortgage lenders may disregard state licensing requirements and other state regulations simply because they are owned by national banks.\footnote{461}{See supra notes 406–09 and accompanying text.}

The OCC’s position that it possesses exclusive supervisory authority over operating subsidiaries also runs afoul of Minnesota v. Fleet Mortgage Corp.\footnote{462}{181 F. Supp. 2d 995 (D. Minn. 2001).} In that case the district court rejected the OCC’s claim of “exclusive jurisdiction” over an operating subsidiary of a national bank.\footnote{463}{Id. at 1001.} The court determined that the operating subsidiary was not “itself a bank” for purposes of section 133(a) of the GLBA.\footnote{464}{GLBA, § 133(a), 113 Stat. 1383 (reprinted in 15 U.S.C.A. § 41 note (2000)). 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 section 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 and loan institutions” from the FTC’s jurisdiction. See 15 U.S.C. § 45(a)(2); see also H.R. REP. No. 106-74, at 137 (1999) (pt. 1); H.R. REP. No. 106-434, at 161–62 (1999) (Conf. Rep.), reprinted in 1999 U.S.C.C.A.N. 245, 256–57.} 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 FTC and state officials under the FTC’s Telemarketing Sales Rule.\footnote{465}{See Fleet Mortgage, 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
Thecourt concluded that section 133(a) of GLBA, which incorporates the definition of “bank” contained in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. § 1813, is unambiguous and “simply does not include subsidiaries of banks.” 467 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.” 468 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 §§ 221 and 221a. 469 Thus, the holding in Fleet Mortgage as to the meaning of “bank” in § 1813 squarely contradicts the OCC’s claim that operating subsidiaries can be treated as national banks under § 484.

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

The OCC asserts that 12 U.S.C. § 24(Seventh) supports its claim of preemptive authority over operating subsidiaries of national banks. 470 However, that statute does not exhibit any congressional purpose to bar the states from regulating operating subsidiaries. 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.” 471 Like § 484(a), § 24(Seventh) refers only to “national banking associations” and does not grant any explicit authority or immunity to “affiliates.” 472

466 Id. at 1001–02 (emphasis added, citations and footnotes omitted).
467 Id. at 1000.
468 Id. (emphasis added).
470 See OCC IL 957, supra note 410, at 6.
allow national banks to establish operating subsidiaries, but it contains no language preempting the authority of states to regulate such subsidiaries.

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.”

This sentence indicates that 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. Unlike certain other types of bank subsidiaries, operating subsidiaries do not derive their authority from any specific statutory grant. 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 language regarding the “incidental powers” of national banks must be construed in a manner consistent with the more specific terms of §§ 221, 221a, 52, 371c, 371c-1, and 481. As shown above in Part III.G.2.b, the statutes dealing specifically with “affiliates” of national banks demonstrate that Congress has not preempted the


475 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.” Similarly, the Bank Service Company Act, 12 U.S.C. §§ 1861–1867, authorizes national banks and FDIC-insured state banks to 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” 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) (2003).

476 See Indep. Ins. Agents of Am. v. Hawke, 211 F.3d 638, 643–45 (D.C. Cir. 2000) (holding that the scope 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); see also Am. Land Title Ass’n v. Clarke, 968 F.2d 150, 157 (2d Cir. 1992) (same), cert. denied, 508 U.S. 971 (1993).
authority of state officials to regulate operating subsidiaries of such banks.

The OCC also claims that section 121(a) of GLBA, codified as 12 U.S.C. § 24a, manifests a congressional intent to give the OCC “exclusive visitorial authority” over operating subsidiaries of national banks.477 Section 24a permits national banks to establish “financial subsidiaries” that may engage in certain activities (e.g., securities underwriting and dealing) that are not lawful for their parent banks.478 At the same time, § 24a requires national banks to satisfy several conditions (including capital requirements, managerial ratings, and community reinvestment standards) in order to establish and maintain “financial subsidiaries.”479

Under § 24a(g)(3), 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.”480 Thus, § 24a(g)(3) simply exempts operating subsidiaries from the federal statutory requirements imposed on financial subsidiaries under § 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 authority of operating subsidiaries of national banks by declaring: “Nothing in this legislation is intended to affect any authority of national banks to engage in bank permissible activities through subsidiary corporations.”481 In fact, Congress understood that § 24a would restrict—not expand—the OCC’s authority to define the powers of operating subsidiaries.482 The conference report on GLBA instructed the OCC to rescind a prior regulation that allowed operating subsidiaries to conduct activities that were not lawful for national banks.483 The OCC responded to GLBA by rescinding its prior rule

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477 See OCC IL 957, supra note 410, at 6; see also OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1901.
479 Id. § 24a(a), (c)–(f).
480 Id. § 24a(g)(3).
483 See id. (stating that § 24a would “supercede [sic] and replace the OCC’s Part 5 regulations on operating subsidiaries”).
and by amending § 5.34(e) of its regulations to make clear that operating subsidiaries may conduct only those activities that are permissible for their parent banks.\textsuperscript{484} It is therefore completely illogical for the OCC to assert that § 24a—a statute intended to restrict the OCC’s authority over operating subsidiaries—can now be construed as a grant to the OCC of additional preemptive power with respect to such subsidiaries.

H. The OCC’s Regulations Do Not Provide a Valid Basis for Exempting Operating Subsidiaries from State Regulation

1. The OCC’s Rulings Are Contrary to the Manifest Intent of Congress

The OCC claims that §§ 5.34(e) and 7.4006 of its regulations\textsuperscript{485} bar state officials from exercising visitorial powers over operating subsidiaries of national banks.\textsuperscript{486} However, neither of those rules provides a valid basis for the OCC’s preemption claim.

Section 5.34(e) does not contain any clear statement of the OCC’s intent to bar the states from regulating operating subsidiaries. Section 5.34(e) describes the federal-law standards that apply to operating subsidiaries, including (i) the requirement that each operating subsidiary must restrict its activities to those permissible for its parent bank and (ii) the application of federal supervisory standards to operating subsidiaries.\textsuperscript{487}

In contrast to § 5.34(e), § 7.4006 does refer explicitly to the issue of whether states have authority to regulate operating subsidiaries of national banks. Section 7.4006 provides that, “Unless otherwise provided by Federal law or OCC regulation, State laws apply to


\footnotesize{485} 12 C.F.R. §§ 5.34(e), 7.4006.

\footnotesize{486} See OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900–01; OCC IL 957, supra note 410.

\footnotesize{487} 12 C.F.R. § 5.34(e). The first sentence of § 5.34(e)(3) provides that “[a]n operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank.” \textit{Id.} § 5.34(e)(3). This sentence does not contain any explicit declaration of the OCC’s intent to preempt state laws, and the remainder of § 5.34(e)(3) discusses federal supervisory standards that apply to operating subsidiaries. \textit{Id.}
national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.”

Thus, according to § 7.4006, federal law preempts the application of state laws to operating subsidiaries to the same extent that federal law precludes the application of state laws to national banks.

It is important to note, however, that § 7.4006 is an interpretive rule and does not preempt state law of its own force. When the OCC adopted the rule in 2001, the agency declared:

> [§ 7.4006] itself does not effect preemption of any State law; it reflects the conclusion we believe a Federal court would reach, even in the absence of the regulation, pursuant to the Supremacy Clause and applicable Federal judicial precedent.

Accordingly, § 7.4006 is not a legislative rule that has substantive preemptive impact. It simply provides the OCC’s suggested interpretation of federal law on the question of whether operating subsidiaries of national banks are subject to state laws. Given its purely interpretive character, § 7.4006 “does not have the force and effect of law.”

488 12 C.F.R. § 7.4006.

489 Investment Securities; Bank Activities and Operations; Leasing, 66 Fed. Reg. 34,784, 34,790 (July 2, 2001) (to be codified at 12 C.F.R. 7.4006)) (emphasis added). As noted above, the OCC’s views as to the permissible exercise of “visitorial powers” over “national banks” are set forth in 12 C.F.R. § 7.4000. Section 7.4000 does not refer to limitations onvisitorial powers with respect to operating subsidiaries. When the OCC adopted its preemption rules and amended § 7.4000, the OCC explained that “the application of state law to national bank operating subsidiaries is dealt with in a different, preexisting regulation, 12 CFR 7.4006, which we did not propose to change.” OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1900 (emphasis added). Thus, the OCC’s preemption and visitorial powers rules “make[ ] no change” to the terms of § 7.4006. OCC Docket 04-04, supra note 1, 69 Fed. Reg. at 1913. As a consequence, the OCC’s recent rulemaking proceedings do not alter the purely interpretive nature of § 7.4006 or its impact on state law.

490 Best v. U.S. Nat’l Bank of Or., 739 P.2d 554, 562 (Or. 1987) (discussing an interpretive rule that expressed the OCC’s view on a similar preemption issue); accord Perdue v. Crocker Nat’l Bank, 702 P.2d 503, 518–19 (Cal. 1985) (same); 1 PIERCE, supra note 323, § 6.4 at 324–25 (explaining that “a legislative rule has the same binding effect as a statute,” while “interpretative rules are not binding on courts or on members of the public”) (emphasis added). Because the OCC explicitly declared that § 7.4006 “does not effect preemption of any State law,” the rule should be evaluated by the courts as an interpretive rather than a legislative rule. A federal agency’s characterization of its own rule is an “important factor in determining whether a rule is interpretive” instead of legislative. Warder v. Shalala, 149 F.3d 73, 80 (1st Cir. 1998), cert. denied, 526 U.S. 1064 (1999); accord Friedrich v. Sec’y of Health & Human Servs., 894 F.2d 829, 835 (6th Cir. 1989), cert. denied, 498 U.S.
Similarly, as indicated by its “interpretive” designation, OCC IL 957 presents the OCC’s view on the same question of whether federal law bars the states from regulating operating subsidiaries. As a consequence, this ruling also does not have any independent force of law.

In evaluating the legal significance of § 7.4006 and OCC IL 957, the key question is whether a reviewing court should defer to the OCC’s “interpretation” of federal law set forth in those rulings. As discussed above, there are strong arguments against granting Chevron deference to OCC “interpretations” that make preemption determinations similar to those asserted in § 7.4006 and OCC IL 957. Moreover, § 7.4006 is expressly based on the OCC’s reading of “applicable Federal judicial precedent.” A federal appellate court refused to defer to similar interpretive rulings that were based on an administrative agency’s assessment of Supreme Court decisions. As the appeals court observed, “There is . . . no reason for courts—the supposed experts in analyzing judicial decisions—to defer to agency interpretations of the [Supreme] Court’s opinions.”

Even if the Chevron doctrine applies to § 7.4006 and OCC IL 957, it is clear that the OCC’s rulings are not entitled to judicial deference.

817 (1990); see also Motor Vehicles Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 50 (1983) (holding that “[i]t is well established that an agency’s action must be upheld, if at all, on the basis articulated by the agency itself”).

Given the purely interpretive nature of § 7.4006, the Supreme Court’s analysis of the preemptive impact of legislative rules in Fidelity Federal Savings & Loan Ass’n v. de la Cuesta, 458 U.S. 141 (1982), and City of New York v. FCC, 486 U.S. 57 (1988), does not apply to § 7.4006. In de la Cuesta and City of New York, the Court considered agency regulations that—unlike § 7.4006—were expressly intended to preempt state law by their own substantive force. See de la Cuesta, 458 U.S. at 145–47; City of New York, 486 U.S. at 59–66.

491 Supra note 410.

492 See 1 PIERCE, supra note 323, § 6.4 at 325 (explaining that “[a] court may choose to give binding effect to the position taken by an agency in an interpretative rule, but it is the court that provides the binding effect of law through its process of statutory interpretation; the agency’s interpretative rule serves only the function of potentially persuading the court that the agency’s interpretation is correct”).

493 See supra notes 270–78 and accompanying text (presenting reasons why OCC preemption determinations should not receive Chevron deference).


495 See Univ. of Great Falls v. NLRB, 278 F.3d 1335 (D.C. Cir. 2002).

496 Id. at 1341 (citation and internal quotation marks omitted); accord New York, New York, LLC v. NLRB, 313 F.3d 585, 590 (D.C. Cir. 2002).
Under the “first step” of *Chevron*, a reviewing court must reject an agency interpretation that “flout[s] Congressional intent” on an issue where “Congress has directly spoken to the precise question.”497 The Supreme Court emphasized that “[i]n determining whether Congress specifically addressed the question at issue, a reviewing court should not confine itself to examining a particular statutory provision in isolation. The meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.”498 In addition, a reviewing court should use “traditional rules of statutory construction” in determining whether the relevant statutes, taken together, manifest a clear congressional intent on the question at issue.499

When § 484 is read in context with the statutes dealing with “affiliates” of national banks, it becomes clear that Congress did not preempt the authority of states to regulate operating subsidiaries of national banks. As shown in Part III.G.2.b, the terms of §§ 221, 221a, 52, 371c, 371c-1, and 481 demonstrate that Congress intended to draw a sharp distinction between national banks and their “affiliates” (including operating subsidiaries). In particular, a careful comparison of §§ 221a, 481, and 484 shows that (i) state officials must file lawsuits instead of administrative complaints to enforce state laws against national banks,500 but (ii) Congress did not restrict the authority of state officials to regulate state-chartered “affiliates” (including operating subsidiaries) of national banks.501 AMTPA and the first proviso of § 24(Seventh) provide further evidence that Congress did not exempt operating subsidiaries from their general duty to comply with applicable state laws.502 Accordingly, § 7.4006 and OCC IL 957 are invalid because they conflict with the clear intent of Congress as revealed in the applicable statutes.503

497 Am. Land Title Ass’n v. Clarke, 968 F.2d 150, 157, 155 (2d Cir. 1992) (quoting *Chevron*, 467 U.S. at 842); accord Indep. Ins. Agents of Am. v. Hawke, 211 F.3d 638, 643–45 (D.C. Cir. 2000); see also Bd. of Governors v. Dimension Fin. Corp., 474 U.S. 361, 368 (1986) (holding that “[t]he traditional deference courts pay to agency interpretation is not to be applied to alter the clearly expressed intent of Congress”).


499 Indep. Ins. Agents of Am., 211 F.3d at 643–45 (quote at 643); see also Am. Land Title Ass’n, 968 F.2d at 155–57.

500 See supra Part III.G.2.a.

501 See supra notes 440–51 and accompanying text.

502 See supra notes 455–61, 470–76 and accompanying text.

503 In addition to failing “step one” of *Chevron*, due to their inconsistency with the clear intent of Congress, the OCC’s interpretive rulings also fail under “step two”
In the final analysis, § 7.4006 is invalid because it represents a unilateral, unauthorized attempt to change the statutory definition of “national bank.” As shown above, the OCC’s expansion of the definition of “national bank” to include operating subsidiaries is contrary to Congress’s explicit definitions of “national bank” and “affiliate” in § 221a and related statutes. In Minnesota v. Fleet Mortgage Corp., the district court rejected the OCC’s argument that an operating subsidiary was “itself a bank” because the OCC’s position conflicted with “unambiguous” congressional intent. Similarly, in Minnesota v. Fleet Mortgage Corp., 505 the district court rejected the OCC’s argument that an operating subsidiary was “itself a bank” because the OCC’s position conflicted with “unambiguous” congressional intent.

504 See supra notes 442–54 and accompanying text.
506 Id. at 1000; see supra notes 458–65 (discussing Fleet Mortgage Corp.). In contrast to Fleet Mortgage, a federal district court in California deferred to the OCC’s position in two recent decisions holding that state officials cannot regulate state-chartered operating subsidiaries of national banks. Nat’l City Bank v. Boutris, No. S-03-0655 GEB J., 2003 WL 21536818, at *3 (E.D. Cal., July 2, 2003) (Burrell, J.); Wells Fargo Bank 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 §§ 221, 221a, 371c, 371c-1, and 481 draw between “national banks” and their “affiliates” (including operating subsidiaries). In addition, the court did not consider the relevance of AMTPA and the first proviso of § 24(Seventh), nor did the court discuss or mention the Fleet Mortgage decision. Finally, the court did not consider the drastic impact that the OCC’s rulings 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 granting deference to the OCC’s claim of “exclusive visitorial powers” over operating subsidiaries.

In Wells Fargo v. Boutris, 265 F. Supp. 2d at 1170, the California court cited WFS Financial, Inc. v. Dean, 79 F. Supp. 2d 1024 (W.D. Wis. 1999). In Dean, the court held that a regulation of the OTS preempted the application of state laws to state-chartered operating subsidiaries of federally-chartered thrift institutions. For two reasons, I believe that Dean does not provide persuasive authority for the Boutris decisions. First, the court in Dean did not consider the impact of the OTS’s rule in subverting the states’ traditional authority to regulate state-chartered corporations. Second, Dean expressly relied on the expansive rulemaking authority granted to the OTS under section 5(a) of HOLA. See 79 F. Supp. 2d at 1026, 1028. As shown above in Part III.F.2, the courts have repeatedly held that the OTS’s authority to preempt state law under HOLA is far greater than the OCC’s power to displace state law under the NBA.
Board of Governors v. Dimension Financial Corp.\textsuperscript{507} the Supreme Court struck down an FRB rule that attempted to define “bank” in a manner that conflicted with the plain terms of the governing statute.\textsuperscript{508} For the same reasons, § 7.4006 is unlawful and does not support the OCC’s claims of exclusive visitorial authority over operating subsidiaries of national banks.

2. The OCC’s Rules Undermine the Enforcement of Consumer Protection Laws Against National Banks and Their Operating Subsidiaries

The OCC’s position set forth in § 7.4006 and OCC IL 957 should also be rejected because it significantly weakens the enforcement of consumer protection laws against national banks and their operating subsidiaries. As discussed above, the OCC declared that (i) state officials have no law enforcement jurisdiction over national banks and their operating subsidiaries and (ii) the OCC has sole authority and discretion to decide whether applicable state laws should be enforced against such entities. Unless the OCC’s position is overturned, the frequency and effectiveness of government enforcement measures will undoubtedly decline with regard to national banks and their subsidiaries.

As previously shown, the states have played a major role in enforcing fair lending laws against financial institutions.\textsuperscript{509} In addition, state officials have been the leaders in combating fraud and other misconduct in the securities and mutual fund industries. New York Attorney General Eliot Spitzer spearheaded the investigation and joined with other state officials and the Securities and Exchange Commission (“SEC”) in obtaining a landmark settlement agreement with ten large Wall Street investment banking firms, including five firms affiliated with major banks.\textsuperscript{510} That agreement requires the ten

\textsuperscript{507} 474 U.S. 361 (1986).
\textsuperscript{508} See id. at 368–75 (invalidating an FRB regulation that conflicted with the “plain meaning” of the definition of “bank” under § 2(c) of the BHCA).
\textsuperscript{509} See supra notes 357–59 and accompanying text (discussing enforcement measures taken by state officials to stop predatory lending, resulting in the payment of large financial penalties by Providian National Bank, First Alliance, and Household International).
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.\footnote{511} News reports confirm that it was Attorney General Spitzer—not federal regulators—who sparked investigations of conflicts of interest and other abuses involving research analysts and investment bankers at Wall Street firms.\footnote{512}

Attorney General Spitzer and Massachusetts Secretary of State William Galvin also led the investigative and enforcement efforts to stop late trading, market timing, and other abusive practices involving mutual funds.\footnote{513} Some of these abuses occurred at funds affiliated with leading national banks, including Bank of America, Bank One, Fleet, and Wachovia.\footnote{514} In March 2004, Bank of America and Fleet


\footnote{512} E.g., Gasparino, supra note 510, at C1; Gretchen Morgenson, \textit{Accord Highlights Wall St. Failures}, \textit{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 1990s,” and “[i]t took Eliot Spitzer . . . to spotlight the issue”).


agreed to pay $675 million to settle charges filed by Attorney General Spitzer and the SEC regarding late-trading and market-timing abuses occurring in mutual funds managed by the two banks.\textsuperscript{515} In November 2003, Attorney General Spitzer filed criminal charges against three former executives of a small, special-purpose national bank that allegedly helped a hedge fund to make illegal trades in mutual funds. The OCC ordered the bank to liquidate after the bank’s misconduct was revealed by Mr. Spitzer’s investigation.\textsuperscript{516}

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.\textsuperscript{517}

\textit{Funds: FleetBoston Units Charged by SEC, New York, Over Market-Timing Scheme}, 36 Sec. Reg. & L. Rep. (BNA) 387 (Mar. 1, 2004) (reporting that the SEC and Attorney General Spitzer had filed civil complaints against two subsidiaries of FleetBoston for allowing outside parties to engage in “a ‘massive’ mutual-fund timing scheme” affecting several of the mutual funds managed by those subsidiaries); Laura Johannes et al., \textit{Fraud Charges Widen Scope of Scandal Facing Mutual Funds}, WALL ST. J., Dec. 12, 2003, at C1 (reporting that Massachusetts regulators had filed civil fraud charges for late trading violations against the former Prudential Securities, which had merged into Wachovia Securities, a joint venture in which Wachovia Corp. is the majority owner).


\textsuperscript{516} See Betz & McTague, \textit{Spitzer Brings Criminal Charges, supra} note 513; Todd Davenport, \textit{Security Trust, 3 Former Execs Accused of Fraud, Am. Banker}, Nov. 26, 2003, at 3 (noting that—according to a joint press release issued by Mr. Spitzer, the OCC and other federal regulators—“Mr. Spitzer’s investigation of late trading and market timing implicated Security Trust and ‘triggered an investigation by the other agencies’ ”).

\textsuperscript{517} See, e.g., Paula Dwyer et al., \textit{Breach of Trust}, BUS. WEEK, Dec. 15, 2003, at 98, 98 (stating that Attorney General Spitzer’s investigation “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. The agency failed to look deeply enough at industry practices to detect patterns of abuse.”); Tom Lauricella et al., \textit{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] investigation in early September. The SEC has scrambled to catch up.”); Mike Maremont & Deborah Solomon, \textit{Missed Chances: Behind the SEC’s Failings: Caution, Tight Budget, ’90s Exuberance}, WALL ST. J., Dec. 24, 2003, at A1 (concluding 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
Members of Congress have lauded state officials and criticized the SEC for their respective enforcement efforts related to the mutual fund industry.518 In response to congressional criticism, 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.”519 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 in the financial markets.520

Thus, state enforcement has proven to be a highly effective and necessary supplement to federal efforts to protect consumers from misconduct involving providers of financial services. It was Attorney General Spitzer—not regulators at the OCC, FRB, or SEC—who first uncovered the conflicts of interest and trading scandals that implicated 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 it did with Wall Street research? . . . Once again, it is the state AGs who are the heroes to individual investors.”); Review and Outlook: Revenge of the Investor Class, WALL S. J., Oct. 23, 2003, at A20 (editorial stating that (i) “with his investigation of the mutual fund industry, the New York Attorney General has been doing a public service” and (ii) “the SEC should have done more to frown on market timing, which wasn’t a secret on Wall Street.”).


520 See Richard Hill, Securities Regulation: Conn. Regulator Declares State Oversight of Industry Trumps Distant Federal Efforts, 35 Sec. Reg. & L. Rep. (BNA) 2103, 2103–04 (2003) (reporting that Antonia Chion, an associate director in the SEC’s Division of Enforcement, told a meeting of state legislators 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 combination.”); Richard Hill, Corporate Governance: Spitzer Decrees CEOs in Ad, Saying Their Language Casts Doubt on Awareness, 36 Sec. Reg. & L. Rep. (BNA) 521, 522 (2004) (reporting that Mark Schonfeld, an associate regional director for the SEC’s northeastern region, “praised state regulators for coming up with creative enforcement methods” and also said that the SEC has “achieved remarkable success when we’ve worked together with the states.”).
securities affiliates and mutual funds operated by major banks and led to the forced dissolution of a small national bank.\footnote{See supra notes 510–18 and accompanying text.} State regulators and consumer advocates argue that the OCC lacks the motivation and administrative resources to enforce consumer protection laws against national banks and their operating subsidiaries.\footnote{See, e.g., 2004 Georgetown Lecture by Spitzer, supra note 201, at 7–13; Testimony of Diana L. Taylor, supra note 354, at 12–19; NCLC Comments, supra note 354, at 12–14; Jathon Sapsford, Critics Cry Foul Over New Rules on Bank Review, WALL ST. J., Jan. 8, 2004, at C1. According to the OCC, its resources for enforcing consumer protection laws include 1800 bank examiners and a single consumer complaint center located in Houston, Texas. See OCC Questions and Answers, supra note 5, at 10. However, the OCC’s examiners are primarily responsible for evaluating the safety and soundness of 2100 national banks and “all” of their “affiliates” (including operating subsidiaries). See 12 U.S.C. § 481; OCC NR 2004-3, supra note 29, at 5; see also Sapsford, supra (noting that “[c]ritics say the OCC has found little evidence of predatory lending among the banks it regulates because it has only 1800 examiners, who are more focused on the quality of the banks’ lending portfolios than [on] their policies for interacting with consumers”). OCC Chief Counsel Julie Williams reportedly admitted, during a public meeting with consumer advocates in 2003, that the OCC could not provide “a comprehensive list of the operating subsidiaries of national banks” because “the number and names of the operating subsidiaries were constantly changing.” NCLC Comments, supra note 354, at 13 n.26. Because large banking organizations have entered more risky lines of business and have adopted more complex organizational structures, it has become increasingly difficult for regulators to assess the safety and soundness of such entities. See Wilmarth, Transformation, supra note 139, 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 2000 national banks and a myriad of operating subsidiaries.} In a recent budget-related resolution, the House 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.”\footnote{2004 House Fin. Serv. Comm. Budget Res., supra note 279, at 16; see also id. (noting that “State banking agencies and State attorney generals’ offices employ nearly 700 full time examiners and attorneys to monitor and enforce consumer law compliance”).} 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 . . . .”\footnote{Id.}
In fact, the OCC’s record in protecting consumers is not 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. 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 allegations of misconduct were filed against several of them.

In one well-known case, the OCC refused to help hundreds of consumers who complained after Fleet raised the interest rates on their credit cards despite promises of a “fixed” rate. 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. The Third Circuit, however, determined that plaintiff presented a genuine issue for trial based on her claim that Fleet’s disclosures were misleading and violated the Truth in Lending Act. Based on the Third Circuit’s opinion, one can

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525 See OCC Docket 04-04, supra note 1, 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 state prosecutor. See supra notes 356–57 and accompanying text. In contrast to the seven public enforcement actions announced by the OCC during 2000–2004, state authorities initiated more than 4000 enforcement actions related to abusive mortgage lending practices in 2003 alone. See supra note 358.

526 See supra note 354 and accompanying text.

527 See Bravin & Beckett, supra note 197 (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”); Testimony of Diana L. Taylor, supra note 354, at 13.


529 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 v. Fleet Bank, 342 F.3d 260, 263 (3d Cir. 2003). 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 its credit card agreements at any time, had not been
certainly question whether the OCC acted properly when it concluded that federal law did not give customers any reasonable grounds for proceeding against Fleet.\footnote{530}

Two other cases indicate that state officials are far more likely than the OCC to take 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.\footnote{531} U.S. Bancorp settled the case by paying a $3 million fine and agreeing to implement new policies designed to safeguard its customers’ privacy.\footnote{532} 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.\footnote{533} However, even though Comptroller Hawke criticized banks for selling customer information to telemarketers under circumstances that were “seamy, if not downright unfair and deceptive,”\footnote{534} the OCC never took public enforcement action against U.S. Bancorp.

In December 2000 Attorney General Hatch sued Fleet’s mortgage operating subsidiary for privacy violations arising out of a similar

\footnote{530} See Bravin & Beckett, supra note 197 (describing a representative letter sent by the OCC to a Fleet customer).


\footnote{533} 15 U.S.C. §§ 6801–6827; Swire, supra note 531, 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 531 (reporting that Minnesota’s suit against U.S. Bancorp “fed a growing firestorm over consumer privacy” and “lawmakers were demanding a legislative crackdown”).

\footnote{534} Swire, supra note 531, 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).
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.”  

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. Once again, the OCC did not take 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. In contrast to the OCC, the FTC filed an amicus brief on behalf of Minnesota.

Since 1999 the OCC 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. Thus, as in the case of predatory lending, 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

536 Id. at 964–65 (describing the factual allegations and legal claims made by Attorney General Hatch against Fleet Mortgage); Kuykendall, Privacy Makeover, supra note 532 (same); see supra notes 462–69 and accompanying text (discussing Minnesota v. Fleet Mortgage Corp., 181 F. Supp. 2d 995 (D. Minn. 2001)).
537 Fleet Mortgage, 181 F. Supp. at 999–1000 (describing the OCC’s arguments, as amicus, supporting Fleet Mortgage Corp.’s motion to dismiss).
538 See id. at 996 (referring to the appearance of counsel for the FTC and the OCC as amici curiae).
539 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, A.M. BANKER, Apr. 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”).
540 See supra notes 329–34, 338, 525–39 and accompanying text (discussing the OCC’s public statements condemning predatory lending, its public enforcement actions against seven smaller national banks, and the absence of any public proceeding by the OCC against a major national bank).
inference clearly seems unwarranted, however, given the number of lending abuses and privacy violations asserted against leading national banks by consumers and state officials. 541

A search of the OCC’s database for publicly available enforcement orders issued during the past decade fails to reveal a single instance in which the OCC issued an enforcement order against one of the eight largest national banks for violating a consumer protection law. 542 Unfortunately, the OCC’s self-interest provides a plausible explanation for the agency’s failure to prosecute publicly 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. 543 As a consequence, the OCC’s bureaucratic incentives create a clear risk of regulatory capture whenever the OCC considers the possibility of taking vigorous enforcement action against one of its most important constituents. Given these circumstances, the OCC should not be allowed to prevent state officials from carrying out their responsibility to protect consumers against unlawful practices committed by national banks or their operating subsidiaries. 544

541 See supra notes 354, 527–39 and accompanying text.

542 As of September 30, 2003, the eight 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), and National City. See Industry Snapshot: Bank and Thrift Holding Companies with the Most Assets; On Sept. 30, 2003; AM. BANKER, Jan. 30, 2004, at 6. By running the names of each of the eight banks through the “Enforcement Actions Search” database on the OCC’s website and reviewing the descriptions of all enforcement orders in which any of the eight banks were named as an interested party since December 31, 1993, one discovers that most of the orders were removal orders or industry-wide prohibitions imposed against bank employees for violations of law. See OCC, Legal and Regulatory: Enforcement Actions Search, at http://www.occ.treas.gov/enforce/enf_search.htm; see also 12 U.S.C. §§ 1818(g), 1829 (2000).

543 See supra notes 193–203 and accompanying text.

544 Mr. Cayne and Ms. Perkins contend that “the OCC has affirmatively reached out to state officials in an effort to engage them in a cooperative role with respect to enforcement of state law against national banks.” Cayne & Perkins, supra note 2, at 383. In fact, however, the OCC’s “reach[ing] out” has been limited to making a pro forma invitation to state officials to “contact the OCC” with information regarding possible violations of law by national banks or their operating subsidiaries. In extending this invitation, the OCC emphasized that (i) the OCC retains sole and exclusive authority to decide whether to “take supervisory action” against a national bank or its operating subsidiary and (ii) the OCC will take such action only if it concludes that a national bank has violated what it deems to be an “applicable law.”
3. The OCC’s Rules Violate Fundamental Principles of Corporate Governance and Invade the Sovereign Power of the States to Regulate State-Chartered Corporations

The OCC’s attempt to bar the states from regulating operating subsidiaries of national banks violates fundamental principles of corporate governance and infringes upon sovereign state interests protected by the Tenth Amendment to the U.S. Constitution. Section 7.4006 and OCC IL 957 ignore the legal separation between a national bank and its operating subsidiaries and also obliterate many of the subsidiaries’ legal obligations under their state corporate charters. As a consequence, the OCC’s rulings run afoul of federal court decisions that emphasize the importance of construing federal statutes in harmony with state corporate law doctrines. For example, in United States v. Bestfoods the Supreme Court declared 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.” Federal court decisions repeatedly rejected attempts to interpret federal statutes in a manner that would override longstanding principles of state corporate law, such as the doctrine of corporate separation, absent clear evidence that Congress intended such a result.

OCC AL 2002-9, supra note 34, at 3–4. In the very same document, the OCC declared that “[e]xclusive federal oversight, uniform federal regulation, and state law preemption constitute three essential and distinct elements of the national bank system.” Id. at 3. Thus, state officials are free to provide information regarding suspected violations of state law to the OCC, but the OCC insists upon (i) exercising total prosecutorial authority and discretion over such information and (ii) deciding whether any state law is “applicable” to national banks and their operating subsidiaries. Not surprisingly, state officials have viewed the OCC’s invitation as the complete antithesis of “cooperative” law enforcement. See 2004 Georgetown Lecture by Spitzer, supra note 201, at 10–13.

546 Id. at 61 (citation and internal quotation marks omitted); see also Dole Food Co. v. Patrickson, 538 U.S. 468, 474–75 (2003) (declaring that “[a] basic tenet of American corporate law is that the corporation and its shareholders are distinct entities. . . . A corporate parent which owns the shares of a subsidiary does not, for that reason alone, own or have legal title to the assets of the subsidiary; . . . ”) (citations omitted); Minnesota v. Fleet Mortgage Corp., 181 F. Supp. 2d 995, 1000 (D. Minn. 2001) (observing that “operating subsidiaries hold a separate incorporated status from their parent banks, and subsidiaries are not chartered as federal banks”).
547 E.g., 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
Congress has clearly expressed its view that natural banks and their “affiliates” should be treated as strictly separate legal entities. The OCC itself has 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 “pierce the corporate veil”) to support its argument that Congress should not be greatly concerned by the possibility that “banks would end up being liable for the debts of their subsidiaries—beyond their own investments and loans.” 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 view that “an operating subsidiary should be considered a part of the [parent] bank, and thus ‘itself a bank’ by extension.”

With the OCC’s blessing, many national banks have organized state-chartered corporations as operating subsidiaries, and those banks represent to customers, counterparties, and regulators that their operating subsidiaries are distinct legal entities. In the area of mortgage

reject this bedrock principle [of corporate separation] and against this venerable common law backdrop, the congressional silence is audible”); Dole Food, 538 U.S. at 475–76 (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”); CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 85, 86 (1987) (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 v. SEC, 905 F.2d 406, 412, 415 (D.C. Cir. 1990) (invalidating 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 Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (quoted supra note 402).

See supra notes 446–50 and accompanying text (discussing the text and legislative history of 12 U.S.C. §§ 221a, 52, 481).


Fleet Mortgage, 181 F. Supp. at 999 (describing the OCC’s position); see also OCC Docket No. 03-16, supra note 1, 68 Fed. Reg. at 46,130 (asserting that “operating subsidiaries and their parent banks [are] equivalents”).
lending, national banks could have forgone the operating subsidiary structure and, instead, could have conducted all of the subsidiaries’ activities directly under their charters as national banks.\footnote{551} However, many national banks have consciously chosen the option of:

establishing operating subsidiaries as a vehicle to limit the portion of their capital exposed by their mortgage operations. . . . This protects the assets backing up the bank’s entire deposit base . . . from being exposed to claims arising from the mortgage lending activities, as they would be if those activities were conducted directly in the bank.\footnote{552}

Thus, national banks have deliberately chosen to take advantage of the legal protections provided by the state corporate charters of their operating subsidiaries, including limited liability. As a result, those subsidiaries are in no position—even with the OCC’s encouragement—to disregard the corresponding state-law duties that attach to them by virtue of those charters.\footnote{553}

The OCC’s claim of exclusive supervisory powers over operating subsidiaries would significantly weaken the historic primacy of the states in matters of corporate regulation. The OCC’s view would deprive states of all authority to license, examine, and regulate state-chartered corporations controlled by national banks. In practical effect, the OCC’s position would “federalize” state-chartered subsidiaries by placing them under the OCC’s sole and exclusive supervisory control.\footnote{554} This “interpretation” of the OCC’s scope of authority over

\footnote{551} See 12 C.F.R. § 5.34(e)(1), (3) (2003) (stating that operating subsidiaries may conduct only those activities that are permissible for their parent banks under the same circumstances).

\footnote{552} Brief of Amici Curiae American Bankers Ass’n et al. at 14, Wachovia Bank v. Burke, No. 303CV0738 (D. Conn. 2003), available at http://www.cn.net.org; see also Cayne & Perkins, supra note 2, at 404 (acknowledging that national banks have organized state-chartered operating subsidiaries “to obtain the benefits of incorporation, such as the limitation of liability inherent to corporations”).


\footnote{554} See Cayne & Perkins, supra note 2, at 404–05 (explaining that, under the OCC’s rules, national bank operating subsidiaries need only follow “the ministerial provisions of state law that provide for the incorporation and governance of state-chartered corporations. As a regulatory matter, however, operating subsidiaries are viewed as mere divisions of the bank . . . [and] are subject to examination and supervision by the OCC to the same extent as the national bank. . . . [T]here is no reason why a state or any other regulator should supervise the activities of a national bank’s operating subsidiaries.”).
operating subsidiaries is indefensible. The federal government intrudes upon the states’ sovereign powers and exceeds the boundaries of its own authority under the Tenth Amendment when it attempts to “convert [state-chartered corporations] into creatures of the federal government” without the permission of the chartering states.\textsuperscript{555} In an

\textsuperscript{555} See Hopkins Fed. Sav. & Loan Ass’n v. Cleary, 296 U.S. 315, 335–40 (1935) (holding that section 5(i) of HOLA violated the Tenth Amendment, because it permitted state-chartered savings institutions to convert to federally-chartered entities, supervised by a federal agency, without state permission); Chi. Title & Trust Co. v. 4136 Wilcox Bldg. Corp., 302 U.S. 120, 126–29 (1937) (holding that 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 Federal).

The OCC has claimed that Hopkins Federal is “factually inapposite” because the agency’s preemption and visitorial powers rules do not change the “charter type or corporate status” of state-chartered operating subsidiaries of national banks. OCC Docket 04-03, supra note 6, 69 Fed. Reg. at 1902. The OCC, however, has overlooked a crucial aspect of Hopkins Federal. In that case, the Supreme Court declared that section 5(i) of HOLA was unconstitutional not only because it allowed state savings institutions to convert to federal charters but also because it permitted them to escape the supervisory control of the chartering state. The Court emphatically held that the federal government could not divest a state, without its consent, of the authority to regulate corporations of its own creation:

A corporation is a juristic person organized by government to accomplish certain ends, which may be public or quasi-public, though for other purposes of classification the corporation is described as private. . . . This is true of building and loan associations in Wisconsin and in other states. They have been given corporate capacity in the belief that their creation will advance the common weal. The state, which brings them into being, has an interest in preserving their existence, for only thus can they attain the ends of their creation. . . . How they shall be formed, how maintained and supervised, and how and when dissolved, are matters of governmental policy, which it would be an intrusion for another government to regulate by statute or decision, except when reasonably necessary for the fair and effective exercise of some other and cognate power explicitly conferred [by the Constitution].

296 U.S. at 337 (citations omitted; emphasis added); see also id. at 340 (holding that Wisconsin had standing to repel “an assault upon the quasi-public institutions that are the product and embodiment of its statutes and its policies” and to prevent such institutions from “deviat[ing] from the law of their creation”).

In Chicago Title the Supreme Court, after quoting the last sentence of the foregoing excerpt from Hopkins Federal, declared that “[h]ow long and upon what terms a state-created corporation may continue to exist is a matter exclusively of state power. . . . The circumstances under which the power shall be exercised and the extent to which it shall be carried are matters of state policy, to be decided by the state legislature.”
analogous case, *Solid Waste Agency of Northern Cook County v. U.S. Corps of Army Engineers*,\(^5\) the Supreme Court refused to give deference to 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.”\(^6\) As shown above, there is no “clear indication” of congressional support for the OCC’s radical attempt to transform state-chartered operating subsidiaries into de facto national banks, thereby overriding the states’ traditional authority to regulate state-chartered corporations and state-licensed providers of financial services.\(^7\)

When Congress has considered it necessary to regulate state-chartered business corporations, it has done so explicitly and incrementally by statute, most recently in the Sarbanes-Oxley Act of 2002.\(^8\) Congress has never chosen to “federalize” corporate law by enacting

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\(^3\) 302 U.S. at 127–28 (citations omitted, emphasis added). The Court held that the federal government could not “breathe life” into a corporation that had been dissolved under state law and, therefore, the corporation’s stockholders could not “resuscitat[e] and continu[e] the corporation” by “invok[ing] the aid of a federal statute.” *Id.* at 128–29.

\(^4\) In sum, based on *Hopkins Federal and Chicago Title*, it is clear that the Tenth Amendment bars the federal government from destroying the states’ sovereign authority to determine the nature, scope, and duration of powers that may be exercised by state-chartered corporations.


\(^6\) *Id.* at 172, 174; *accord* Univ. of Great Falls v. NLRB, 278 F.3d 1335, 1340–41 (D.C. Cir. 2002) (holding that the “constitutional avoidance canon of statutory interpretation trumps *Chevron* deference”—accordingly, the court refused to give deference to an agency interpretation that raised serious constitutional questions and was not supported by any “affirmative intention of the Congress clearly expressed”) (citations and internal quotation marks omitted).

\(^7\) See, e.g., *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987) (declaring that it is “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”); *Dole Food Co. v. Patrickson*, 538 U.S. 468, 475–76 (2003) (refusing to revise the doctrine of corporate separation “so far that, as a categorical matter, all subsidiaries are deemed to be the same as the parent corporation”); * supra* notes 398–409, 545–47 and accompanying text (discussing Congress’s longstanding support for state regulation of corporate governance and financial services).

a comprehensive, preemptive regime that ousts the states from supervising state-chartered entities. In sharp contrast to the OCC’s assertion of exclusive federal control over state-chartered operating subsidiaries, the regulatory regime for business corporations in this nation has long followed a policy of decentralization, which has made possible a horizontal competition among the states and a vertical competition between the states and the federal government. The competitive dynamic inherent in our system of corporate regulation is similar to the competition among the states, and between state and federal regulators, that has occurred within the dual banking system. See supra Part III.B.2. For discussions of the regulatory competition that has been fostered by the federalism principles inherent in American corporate law, see Renee Jones, Rethinking Corporate Federalism in the Era of Corporate Reform, 29 J. Corp. L. (Spring 2004) (forthcoming 2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=459400; Brett McDonnell, The Ambiguous Virtues of Federalism in Corporate Law, Minn. Pub. L. Res. Paper No. 03-10 (July 15, 2003), available at http://ssrn.com/abstract=424681; Mark J. Roe, Delaware’s Competition, 117 Harv. L. Rev. 588 (2003); Jonathan R. Macey, Securities and Exchange Nanny, Wall St. J., Dec. 30, 2003, at A10.

As noted by Brett McDonnell and Mark Roe, Congress has from time to time, by specific legislation, imposed federal standards that limit the scope of the states’ authority over business corporations. The Sarbanes-Oxley Act is the most recent example of congressional intervention in this area. However, there have been ebbs as well as flows in the amount of congressional oversight of business corporations. For example, in the 1980s and early 1990s, influenced in part by important Supreme Court decisions, Congress chose not to preempt the states’ authority with respect to (i) the establishment of fiduciary duty rules for corporate officers and directors and (ii) permissible defenses to corporate takeovers. During the same period, the courts rejected several attempts by the SEC to override state law in those areas. The courts determined that the SEC did not possess the requisite authority to adopt regulations preempting state laws in those fields. See McDonnell, supra, pt. VII.; Roe, supra, at 603–34.

Commentators who support a continuing role for the states in regulating corporations argue that “corporate federalism” produces benefits similar to those described above with regard to the dual banking system. See supra Part II.B.2. For example, supporters contend that state regulation of corporations (with a superintending check from Congress) fosters experimentation, innovation and flexibility in corporate law, while preserving a “safety valve” that permits corporations to escape from outmoded, oppressive or corrupt regulation. See, e.g., Stephen M. Bainbridge, The Creeping Federalization of Corporate Law, Regulation, 26, 30–31 (Spring 2003), available at http://www.cato.org/pubs/ regulation/regv26n1/v26n1-5.pdf; Jones, supra, pts. II., III.; Macey, supra; McDonnell, supra, pts. V., VII.; Ribstein, supra note 559, at 57–61.

authorized the OCC to adopt regulations “federalizing” an important category of state-chartered corporations. In the absence of any explicit grant of authority from Congress, the OCC’s sweeping claim of exclusive supervisory control over state-chartered operating subsidiaries is not entitled to judicial deference, and should be rejected as invalid under the prudential rule applied by the Supreme Court in *Solid Waste Agency.*

IV. Conclusion

In both design and practical effect, the OCC’s new preemption and visitorial powers rules create a regime of de facto field preemption. Under these rules national banks and their operating subsidiaries are no longer required to observe any state laws except for “incidental” laws that, in the OCC’s opinion, “promote” the ability of national banks to conduct their federally-authorized activities. The new rules effectively permit the OCC to “pick and choose” the state laws that apply to national banks and their operating subsidiaries. The rules also give the OCC sole discretion to decide whether to enforce any such laws against the agency’s regulated constituents.

The OCC’s new preemption regime is clearly designed to advance the OCC’s self-interest by persuading large, multistate banks to operate under national charters. The OCC’s rules give large state banks with interstate branches powerful incentives to convert to national charters so that they too can obtain a blanket exemption from inconvenient state laws. 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 therefore 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 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. Given the OCC’s powerful incentives for attracting and retaining the loyalty of major banks, the OCC should not be entrusted with sole responsibility for enforcing consumer protection laws against its regulated constituents. The OCC’s rules will also deprive the states of any meaningful role in regulating a significant category of state-chartered business corporations. The OCC’s rules thus represent a major expansion of federal control over corporations, a step that could provide further momentum toward the adoption of a general federal corporate law.

Undoubtedly Congress could command, by affirmative legislation, a drastic change in our financial system similar to that imposed by the OCC’s new rules.\footnote{See, e.g., Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 57–58 (2003) (per curiam) (discussing Congress’s broad authority to regulate banking and other financial services under the Commerce Clause). It should be noted, however, that the Tenth Amendment appears to place some constraints on the power of Congress to interfere with the states’ supervisory authority over state-chartered corporations. As a consequence, Congress’s power to regulate state-chartered operating subsidiaries of national banks may not be unlimited. See supra note 555 and accompanying text; cf. Citizens Bank, 539 U.S. at 58 (acknowledging that “the power [of Congress] to regulate commerce, though broad indeed, has limits” (citation and internal quotation marks omitted)).} However, Congress has not done so. Over the past century Congress has repeatedly acted to preserve the dual banking system and to maintain a competitive equilibrium between state and national banks. In 1994 Congress made clear in the Riegle-Neal Act that it remained strongly committed to the fundamental tenets of the dual banking system, including the general application of state laws to both state and national banks. The Riegle-Neal Act endorsed the judicially-established principle that state laws do apply to national banks in the absence of an irreconcilable conflict with federal law. Without a fresh grant of authority from Congress, the OCC had no authority to adopt its far-reaching rules. Congress and the courts must therefore act to overturn the OCC’s rules and restrain the agency’s future ability to preempt state laws.