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# FEDERAL PREEMPTION AND THE CHALLENGE TO MAINTAIN BALANCE IN THE DUAL BANKING SYSTEM

ROBERT C. EAGER<sup>1</sup> AND C. F. MUCKENFUSS, III<sup>2</sup>

## I. INTRODUCTION

In early 2004, the Comptroller of the Currency (Comptroller or OCC) adopted revised preemption regulations providing that national banks engage in banking effectively subject only to the National Bank (NB) Act under the regulatory and enforcement authority of the OCC.<sup>3</sup> Although controversial, this regulation represents a coherent response to the realities and demands of a national marketplace for financial services. State response to the OCC has been swift and forceful. In comments on the OCC rules,<sup>4</sup> in litigation,<sup>5</sup> and in Congressional oversight hearings,<sup>6</sup> state bank regulators, state attorneys general, consumer groups, and members of Congress have decried the effects of these rules on the dual banking system and federalism<sup>7</sup> and questioned

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1. Robert C. Eager, Partner, Gibson Dunn & Crutcher, LLP., Washington D.C.

2. C.F. Muckenfuss III, Partner, Gibson Dunn & Crutcher, LLP., Washington D.C.

3. See 12 C.F.R. pts. 7, 34 (2004).

4. See, e.g., Letter from Mark Rotenberg, Executive Director, ELECTRONIC PRIVACY INFORMATION CENTER; Chris Jay Hoofnagle, Deputy Counsel, ELECTRONIC PRIVACY INFORMATION CENTER; Kerry Smith, Clerk, ELECTRONIC PRIVACY INFORMATION CENTER; and Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, to the OFFICE OF THE COMPTROLLER OF THE CURRENCY (April 8, 2003), available at <http://www.pirg.org/atm99/pdfs/visit.pdf> (last visited Feb. 13, 2004).

5. See, e.g., Brief of Amici Curiae, State and State Banking Officials in Support of John P. Burke, Banking Commissioner, Wachovia v. Burke, Civ. Action No. 3:03 CV 0738 (JCH) (Aug. 26, 2003).

6. See *infra* notes 40-51 and accompanying text.

7. "Dual banking system" refers to the parallel state and federal structures for the charter, supervision, and regulation of depository institutions. It encompasses both the powers, activities, and competitiveness of chartered banks as well as the powers, policies, and institutional structure of the bank regulatory agencies at the state and federal levels (including the Federal Reserve Board (Fed) and Federal

the wisdom and authority of the OCC.<sup>8</sup> While there can be no certainty, if the past is a guide, there will be Congressional discussion, but no legislation, and the courts will substantially sustain the OCC position.<sup>9</sup>

In the existing multi-state marketplace, a uniform national bank system based on preemption undoubtedly presents a major challenge to the dual banking system and state bank regulation. If state banks cannot operate multistate with the same efficiency and effectiveness as national banks, the state banking system ultimately will be irreparably undermined. Responding positively to this challenge is strategically important for *all banks*, national and state, because both have a significant stake in the choice afforded by a strong and balanced dual banking system.

It is important to the future of the dual banking system to mount a positive response to the preemption challenge, even while the contentious and adversarial processes already underway continue under their own momentum. By using the existing conceptual framework and legal tools, a robust dual banking system can be maintained. That is a constructive and necessary response to the broad preemption provided to all federal institutions under the OCC and Office of Thrift Supervision (OTS) rules.

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Deposit Insurance Corporation (FDIC) as the primary federal regulators of state-chartered banks). Throughout the history of the dual banking system, one of its most important features has been a relative balance between the state and national systems, both in numerical terms and in the perception among bankers of the relative attractiveness of the two types of charters.

8. *Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004), available at <http://financialservices.house.gov/media/pdf/012804tm.pdf> (statement of the Honorable Thomas J. Miller, Attorney General, State of Iowa on behalf of the National Association of Attorneys General at 3, n.5, 6).

9. See *Final Rules on National Bank Preemption*, 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004) (noting that the OCC's preemption standard conforms with Supreme Court precedent); see also *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 34 (1996) ("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" (internal quotation omitted)); see generally *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984) (affording deference to agency constructions of the statutes which they administer). *Contra*, Letter from Rep. Frank Barney (D-Mass.), et. al. to John D. Hawke, Jr., Comptroller of the Currency (Feb. 11, 2004), available at [http://www.house.gov/banking\\_democrats/Ltr-OCCHawkepreemptiondelarules.pdf](http://www.house.gov/banking_democrats/Ltr-OCCHawkepreemptiondelarules.pdf) (last visited Feb. 13, 2004) ("We are deeply concerned that [the new rules] represent a fundamental shift in bank regulation that goes to the very heart of the federal system.").

In the national financial services marketplace, consumers and providers benefit when banks can provide products and services under a single legal framework applicable across state lines. Bank customers and the economy also have benefited from the diversity, innovation and checks provided by the dual banking system. From the perspective of all parties — consumers, financial institutions, and regulators, — further development of a framework of state bank regulation and supervision that is effective, efficient, and seamless across state lines is the right goal. But state bank regulation and the dual banking system will remain vital and strong *only* if the state system is able to provide complete interstate parity for state banks.

The proposed positive response is well grounded in current law and the established policy of Congress to maintain equilibrium in the dual banking system. In response to the challenges presented by the 1978 *Marquette* case<sup>10</sup> and the 1994 Riegle-Neal interstate banking legislation,<sup>11</sup> Congress enacted federal statutes based on the concept that state as well as national banks must be able to operate under a single law when they do business across state lines. Section 104 of the 1999 Gramm-Leach-Bliley Act similarly provides national parity for all banks and their affiliates. The interstate supervisory regime developed by the Conference of State Bank Supervisors since 1994 also relies on home state law and regulation.

In this article we review those federal and state actions over the last quarter century that were taken to maintain balance in the dual banking system by allowing state banks to operate across state lines under uniform rules supported by a preemptive federal statute. With the federal preemption provided by these tools, the existing parity framework can, and we believe should, be further developed so that banks with state charters can compete safely, efficiently, and fairly in the national marketplace for financial services substantially under their home state law and regulation. Although further federal legislation may not be required to

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10. See *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).

11. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 238 (codified as amended in scattered sections of 12 U.S.C.).

develop such a parity framework, specific, limited, clarifying amendments to current law could facilitate the completion of a parallel, substantially uniform state system.<sup>12</sup>

- After a brief historical background and review of the recent OCC preemption rules in Part II, this article will discuss the federal and state laws and actions that together provide a framework for competitive parity in the dual banking system as well as a basis for further actions to maintain balance within that system.
- Part III considers the landmark *Marquette National Bank v. First Omaha Service Corp*<sup>13</sup> case (*Marquette*), and § 27 of the Federal Deposit Insurance Act<sup>14</sup> (§ 27), passed two years after the decision in *Marquette*. Together, *Marquette* and § 27 allow both national and state chartered banks to lend interstate at the rates permitted under the usury laws of the state where they are “located.”
- Part IV discusses the framework established by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal I) and subsequent Riegle-Neal Amendments Act of 1997 (Riegle-Neal II).<sup>15</sup> The Riegle-Neal interstate banking legislation (1994 and 1997) enacted substantively identical provisions to describe the law applicable to interstate national and state banks with the stated purpose of providing parity for state banks with national banks. At a minimum, this provision means that state banks with branches in another state can operate with parity to national banks. The legislative history supports a

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12. See *infra* note 106 and accompanying text.

13. *Marquette*, 439 U.S. 299 (1978).

14. 12 U.S.C. 1831d(a) (2000).

15. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. 103-328, 108 Stat. 2338 (1994) (codified at various sections of 12 U.S.C.) [hereinafter Riegle-Neal I]; the Riegle-Neal Amendments Act of 1997, Pub. L. 105-24 (1997) (amending 12 U.S.C. § 1831a(j)) [hereinafter Riegle-Neal II].

broader parity for state and national banks through a framework in which the home state law of an interstate state bank applies as the National Bank Act applies to an interstate national bank.

- Part V discusses § 104 of the 1999 Gramm-Leach-Bliley Act<sup>16</sup> (GLBA). GLBA authorized a broad range of financial affiliations for banks. Section 104 of this legislation provides express federal preemption for an unprecedented range of companies: not only all state and federal insured banks and thrifts, but also all “financial” affiliates of all those insured depository institutions. Under § 104, any state law that is discriminatory or unduly burdensome (as defined) for any such entity is preempted.
- Part VI briefly discusses the potential application of the Interstate Commerce Clause in the U.S. Constitution<sup>17</sup> to restrict the ability of the states to impose barriers and burdens on interstate commerce (the “negative” Commerce Clause).
- Part VII discusses the efforts of the states, under the leadership of Conference of State Bank Supervisors (CSBS), to provide a seamless regulatory and supervisory regime for state banks operating on a multi-state basis.<sup>18</sup>

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16. 15 U.S.C. § 6701 (2001 & Supp. 2003).

17. U.S. CONST. art. I, § 8, cl. 3.

18. The enactment of Riegle-Neal II, which was spearheaded by CSBS, and the CSBS cooperative agreements advance the export model — that *home* state law and regulation should follow a bank chartered by that state when it establishes branches and engages in business in other states. These CSBS actions break new ground by recognizing the need for federal enabling legislation and by contracting the role of each state banking department in its role as a *host* state agency. The state bank supervisors and CSBS have in practical terms ceded some of their jurisdiction in order to permit the state banking system as a whole to function in a manner more parallel to the national banking system. This approach represents a major, if not widely acknowledged, state innovation in keeping with the creative tradition of the dual banking system.

- Part VIII suggests actions that might be taken to maintain balance in the dual banking system, including rulemaking under existing laws by the FDIC or Fed, use of amicus briefs to develop the state bank position in banking preemption cases, targeted federal statutory amendments, and creation of a working group of banks to develop priorities and provide resources for a concerted effort to maintain balance in the dual banking system.

Before proceeding with this discussion, three related points should be highlighted. First of all, the approach suggested in this article is not without difficulty. In order to effect a seamless web of regulation across state lines, state regulators must both cede sovereignty and cooperate effectively. Issues of budget and resources, quality and effectiveness of regulation, the role of the FDIC and the Fed and a myriad of technical and mechanical issues must be faced, but are beyond the scope of this article.

Second, we believe that there should be urgency in state responses to the OCC's actions. A healthy dual banking system includes both state and national institutions that are local, regional and national and that provide each system perspective and adequate financial and political resources. If state banks cannot maintain parity with national banks operating with broad federal preemption in today's interstate banking environment, there is the distinct possibility of transactions that would remove, one-by-one, a critical mass of large, interstate state banks<sup>19</sup> and fundamentally upset the essential balance in the dual banking system. Providing parity under a parallel framework permitting uniform multistate operations by state banks is unquestionably necessary. It seems highly unlikely that any major multistate national bank would ever convert to a state charter if it could not keep the ability to operate under a uniform legal framework across state lines.

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19. The present dual banking system draws strength from the presence of one or two very large state banks in a number of states (e.g., Georgia, North Carolina, Virginia, Ohio, Michigan, among other.), as well as the concentration of state banks in such states as New York, Alabama, and Utah.

The third point flows from the first two. A failure to commit the necessary resources, intellectual, political and otherwise, to assure a workable framework for multistate state banks is likely to result in the loss of the very substantial benefits that the dual banking system provides for all banks, for bank customers and for the economy.

## II. BACKGROUND: HISTORY AND RECENT DEVELOPMENTS

The recent OCC rules may be viewed as only the latest chapter in a history in which federal and state law have attempted to meet, and often catch up to, the needs of an increasingly integrated national marketplace.

### A. *Brief Historical Overview*

Since the creation of the national banking system in the 1860s, the United States has had a “dual” banking system. Although some drafters of the National Bank (NB) Act thought the new federal system might replace the existing state banking system in each state, a dual banking system resulted instead. Nevertheless, the concept of competitive parity has its origins in the NB Act itself, which explicitly provides that national banks must look to home state law in such areas as usury, trust powers, and, as added by the 1920’s McFadden Act, intrastate branching.<sup>20</sup> These provisions ensured that national banks would have competitive parity with home-state state banks in an intrastate banking framework. The later establishment of the Federal Reserve System and Federal Deposit Insurance Corporation (FDIC) insurance treated national and state chartered banks equally and thus supported competitive parity in the dual banking system.

As banking expanded to become an increasingly multi-state business after the 1960’s, the advantages of federal preemption became more apparent. The development of multi-state credit cards and interstate offers of consumer credit signaled the

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20. See 12 U.S.C. §§ 36, 85, 92a (2001).



development of a banking (now financial services) marketplace that is truly national in scope. The federal agencies that charter and regulate federal banking institutions, the OCC for national banks and the OTS for federal savings associations, have acted to ensure that state regulation does not impinge on activities of these federal instrumentalities.

The nationalization of financial markets required both Congress and state banking regulators, through the CSBS, to take a fresh look at the needs of state banks. In the last two decades, Congress has expressed a national policy of parity for state and national banks in the national financial market while also extending federal preemption to all bank-affiliated providers of financial services. Before turning to the federal statutory framework providing competitive parity for state banks in an interstate environment, we will briefly review the debate over the recent OCC preemption actions.

#### *B. Recent OCC Preemption Actions*

The OCC recently restated and codified its regulations regarding the extent to which the operations of national banks are subject to state laws. On Aug. 5, 2003, the OCC issued an order preempting several provisions of the Georgia Fair Lending Act (GFLA).<sup>21</sup> This action paralleled preemption actions and rules by the OTS and represented only the most visible in a number of preemption determinations concerning new “predatory” lending laws enacted in other states.<sup>22</sup> The OCC also published a notice of proposed rulemaking to amend 12 C.F.R. parts 7 and 34 in order

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21. Preemption Determination and Order, 68 Fed. Reg. 46,264 (Aug. 5, 2003). In its order, the OCC concluded that “the conditions imposed by the GFLA on the real estate lending activities of national banks” do not apply to national banks or national bank operating subsidiaries engaging in real estate lending activities in Georgia. *Id.* at 46,281.

22. See OTS Op. Chief Counsel, P-2003-1 (Jan. 21, 2003), available at <http://www.ots.treas.gov/docs/56301.pdf> (last visited Feb. 13, 2004) (asserting that federal law preempts that application of various provisions of the GFLA to federal savings associations and their operating subsidiaries and citing several similar OTS decisions); see also, Final Rule: Lending and Investment, 61 Fed. Reg. 50,965 (Sept. 30, 1996).

to clarify the applicability of state law to nationally chartered banks.<sup>23</sup> On January 13, 2004, the OCC published final rules amending parts 7 and 34, which took effect on Feb. 12, 2004.<sup>24</sup>

### 1. Preemption of Georgia Fair Lending Act

The OCC's order preempting the real estate lending provisions of the GFLA was illustrative of the agency's policy of applying general preemption principles to questions concerning the regulation of interstate lending.<sup>25</sup> The OCC determined that the GFLA's provisions affecting a national bank's ability to engage in real estate lending, the rate of interest a national bank may charge for a loan, and a national bank's ability to charge non-interest fees were preempted because "[u]nder applicable Federal preemption principles, based on the Supremacy Clause of the U.S. Constitution<sup>26</sup> and articulated by the U.S. Supreme Court, a state may not modify a Congressional grant of power to national banks by limiting, conditioning, or otherwise impermissibly affecting a national bank's exercise of that power."<sup>27</sup>

### 2. Revised OCC Preemption Regulations

On Jan. 13, 2004, the OCC published a final rule to "specify the types of state laws that do not apply to national banks' lending and deposit taking activities *and* the types of state laws that generally *do* apply to national banks."<sup>28</sup> The regulations explicitly provide that state laws do not apply to national banks if such laws "obstruct, impair, or condition" the ability of national banks to

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23. Notice of Proposed Rulemaking, 68 Fed. Reg. 46,119 (Aug. 5, 2003).

24. Final Rules on National Bank Preemption, 69 Fed. Reg. 1904.

25. Preemption Determination and Order, 68 Fed. Reg. 46,264.

26. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. CONST., art. VI, cl. 2.

27. Preemption Determination and Order, 68 Fed. Reg. at 46,264. The OCC pointed out that national banks' authority to engage in real estate lending derives from federal law. *Id.*; see also 12 U.S.C. § 371(a) (2003); 12 U.S.C. § 24 (Seventh).

28. Final Rules on National Bank Preemption, 69 Fed. Reg. at 1904.

exercise their federally authorized deposit-taking,<sup>29</sup> consumer lending,<sup>30</sup> and other powers.<sup>31</sup> However, state laws that only incidentally affect the deposit-taking, lending, or other operations of a national bank are not preempted.<sup>32</sup> The OCC also revised its rule concerning its visitorial powers to make plain that it alone has the authority to bring enforcement actions against national banks and that state authorities cannot bring an action against a national bank or subsidiary in a state court.<sup>33</sup> On Jan. 7, 2004, when the OCC issued the new regulations, Comptroller of the Currency John D. Hawke, Jr., issued a statement noting:

The types of laws that the regulation preempts — including laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses — create impediments to the ability of national banks to exercise powers that are granted under federal law. These laws create higher costs and operational burdens that the banks either must shoulder, or pass on to consumers, or that may have the practical effect of driving them out of certain businesses.<sup>34</sup>

The OCC stated that its authority to issue the new regulations derives from 12 U.S.C. §§ 93a and 371.<sup>35</sup> Section 93a grants the OCC authority “to prescribe rules and regulations to carry out the responsibilities of the office” and § 371 grants the

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29. 12 C.F.R. § 7.4007(b) (2004).

30. 12 C.F.R. §§ 7.4008(d), 34.3, 34.4 (2004).

31. 12 C.F.R. § 7.4009(b) (2004).

32. Press Release, Office of the Comptroller of the Currency, Preemption Final Rule Questions and Answers (Jan. 7, 2004), *available at*, <http://www.occ.treas.gov/2004-3dPreemptionQNAs.pdf> (last visited Feb. 7, 2004). The OCC noted that “[t]hese include laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts.” *Id.*

33. Final Rule on Visitorial Powers, 69 Fed. Reg. 1895 (Jan. 13, 2004).

34. Press Release, John D. Hawke, Jr., Comptroller of the Currency, Statement of Comptroller of the Currency John D. Hawke, Jr. Regarding the Issuance of Regulations Concerning Preemption and Visitorial Powers (Jan. 7, 2004), *available at* <http://www.occ.treas.gov/2004-3aComptrollersstatement.pdf> (last visited Feb. 7, 2004).

35. Final Rules on National Bank Preemption, 69 Fed. Reg. at 1908-09.

OCC authority to regulate national banks' real estate lending activities.<sup>36</sup>

In response to concerns that the preemption of state predatory lending laws will expose consumers to abusive and predatory lending practices, the OCC included two new provisions to address these concerns. First, the new regulations “*prohibit a national bank from making any consumer loan – including any form of mortgage loan, automobile loan, and student loan – that is based predominately on the bank’s expectation that it will be repaid through foreclosure or liquidation of collateral that the consumer used to secure the loan.*”<sup>37</sup> Second, the new regulation prohibits national banks from engaging in practices that are unfair and deceptive under the Federal Trade Commission (FTC) Act in connection with all types of lending.<sup>38</sup> The OCC stated that although the agency does not have the authority under the FTC Act “to adopt rules defining particular acts or practices as unfair or deceptive under that Act,” it does have the authority to take enforcement action where it finds unfair and deceptive practices.<sup>39</sup>

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36. In *Conference of State Bank Commissioners v. Conover*, the D.C. Circuit confirmed that §§ 93a and 371 authorize the OCC to issue regulations preempting state law. 710 F.2d 878, 884-85 (D.C. Cir. 1983).

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

*Id.* at 885.

37. Press Release, Office of the Comptroller of the Currency, Preemption Final Rule Questions and Answers (Jan. 7, 2004), *available at* <http://www.occ.treas.gov/2004-3dPreemptionQNAs.pdf> (last visited Feb. 7, 2004) (emphasis in original).

38. *Id.*

39. *Id.* The OCC also asserted that it has been effectively addressing predatory lending by reviewing bank lending activities under various Federal laws, including the Homeowners Equity Protection Act of 1994 (HOEPA), the Fair Housing Act, and the Equal Credit Opportunity Act, as well as the FTC Act. Final Rule on Preemption, 69 Fed. Reg. at 1913.

C. *Oversight hearings: "Congressional Review of OCC Preemption," Jan. 28, 2004*

Soon after the OCC finalized its preemption rules, Chairwoman Sue Kelly (R-N.Y.) of the Subcommittee on Oversight and Investigations of the House Financial Service Committee scheduled a hearing at which the OCC and its state critics testified. The broad contours of the debate were foreshadowed in the opening statements of Chairwoman Kelly and full Committee Chairman Michael G. Oxley (R-Ohio). In her statement, Rep. Kelly said that she had asked the OCC to defer implementation of the rules pending Congressional review. She stated:

[T]he OCC is tasked with interpreting Congressional intent, and in terms of these regulations, the intent of Congress is unclear. . . . This request presents the OCC with a tremendous opportunity to display to Congress and consumers that the agency takes this review seriously and is willing to address concerns with the regulations.<sup>40</sup>

Chairman Oxley disagreed, stating that "the OCC regulations represent a thoughtful attempt to codify and harmonize past legal precedents, and there are many, and regulatory guidance into a coherent framework for resolving conflicts between Federal and State laws as they apply to national banks."<sup>41</sup> He added:

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40. *Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004) (statement of Chairwoman Sue Kelly at 1-2) available at <http://financialservices.house.gov/media/pdf/012804ke.pdf> (last visited Feb. 14, 2004).

41. *Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004) (opening statement of Full Committee Chairman Michael G. Oxley at 1) available at <http://financialservices.house.gov/media/pdf/012804ox.pdf> (last visited Feb. 13, 2004).

Our dual system of national and State bank chartering is a unique feature of the U.S. financial marketplace, and has served the American economy and American consumers well for almost 200 years. Since the inception of the dual banking system, tension has periodically flared between Federal and State authorities over the proper allocation of responsibility for overseeing the activities of national banks. The regulations issued in final form by the Comptroller earlier this month, after a period for notice and comment, are the latest chapter in that long-running debate.<sup>42</sup>

### 1. OCC Testimony

First Senior Deputy Comptroller and Chief Counsel Julie L. Williams explained the rationale for the OCC action:

As we explained in the preamble to the preemption rule, markets for credit, deposits, and many other financial products and services are now national, if not international, in scope, as a result of significant changes in the financial services marketplace, particularly in the last 20 years. Now, more than ever before, the imposition of an overlay of 50 State and an indeterminate number of local standards and requirements on top of the Federal requirements and OCC supervisory standards to which national banks already are subject has costly consequences that materially affect a national bank's ability to serve its customers.<sup>43</sup>

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42. *Id.*

43. *Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004) (statement of the Honorable Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency at 6) available at <http://financialservices.house.gov/media/pdf/012804jw.pdf> (last visited Feb. 13, 2004).

She then addressed the implications for the dual banking system:

Some critics have suggested that by codifying in regulations the exclusivity of the OCC's supervision of national banks and the types of State laws that are, or are not, preempted as applied to national banks, the OCC "will demolish" the dual banking system, or "deprive bankers of a choice of charters." Distinctions between State and Federal bank charters, powers, supervision, and regulation are not contrary to the dual banking system; they are the essence of it. . . . It is important to remember that the dual banking system offers American consumers a choice—those who believe the State system offers greater protections, or desirable variety, are free to make that choice.<sup>44</sup>

### 3. The State Position

Expressing the state position on behalf of the CSBS was Diana Taylor, New York Superintendent of Banks, who characterized the OCC rules as a "kind of *de facto* 'field preemption.'"<sup>45</sup> She asserted that when addressing preemption the OCC should follow the "process of notice and consultation for the preemption of state laws" embodied in Riegle-Neal.<sup>46</sup> She urged Congress to "intervene to reaffirm the balance of our dual banking

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44. *Id.* at 15.

45. *Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004) (statement of the Ms. Diana L. Taylor, New York Superintendant of Banking, on Behalf of the Conference of State Bank Supervisors at 11) *available at* <http://financialservices.house.gov/media/pdf/012804dt.pdf> (last visited Feb. 13, 2004). Iowa Attorney General Thomas Miller also testified. *See Congressional Review of OCC Preemption Before the Subcommittee on Oversight and Investigations House Committee on Financial Services*, 109th Congress (Jan. 28, 2004) (statement of the Honorable Thomas J. Miller, Attorney General, State of Iowa on behalf of the National Association of Attorneys General) *available at* <http://financialservices.house.gov/media/pdf/012804tm.pdf> (last visited Feb. 13, 2004).

46. *Id.* at 11.

system and reject the OCC's drive to change our system of regulation and applicable law so radically without any Congressional input."<sup>47</sup> She summarized the state critique of the OCC rules:

The traditional dynamic of the dual banking system has been that the states experiment with new products and services that Congress later enacts on a nationwide basis. We generally discuss this history in terms of expanded powers, but the states have been innovators in the area of consumer protection, as well. . . .<sup>48</sup>

The OCC is attempting to short-circuit this dynamic with the sweeping *de facto* "field preemption" of these recent regulations. States may continue to seek new ways to protect their citizens, but if the OCC's regulations were to be upheld, these efforts would be ineffectual, because the laws would not apply to the customers of most of the nation's largest financial institutions who increasingly control much of the nation's financial assets. . . . If you lose the states as a laboratory for consumer protections and other innovations you lose a great attribute of our federalist system – the ability to find out what does and doesn't work.<sup>49</sup>

. . . .

This debate should not be about protecting or advancing one charter over another. It should not be about turf. It should be about creating the best structure for a financial services system that allows a wide range of financial institutions to compete effectively and make their products and services available to all segments of our nation, and that offers consumers protection and remedies against

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47. *Id.* at 5

48. *Id.* at 9.

49. *Id.* at 10.



fraudulent and misleading practices – no matter the charter of the consumers’ financial institution. If Congress finds that federal preemption is necessary to achieve this goal, we will accept that. With his actions, however, the Comptroller of the Currency is trying to cut off this discussion altogether.<sup>50</sup>

Although this hearing, like the comment period on the OCC rules, provided a forum for the OCC’s critics, the statement by Chairman Oxley signaled that he is not disposed to allow action that would undo the OCC rule. The state furor is now being channeled into litigation.<sup>51</sup>

### III. INTERSTATE LENDING PARITY: *MARQUETTE* AND THE SECTION 27 RESPONSE

The 1978 *Marquette* case dramatically demonstrated the power of federal preemption by validating the ability of national banks to “export” consumer credit interstate at uniform favorable interest rates.<sup>52</sup> That case signaled a fundamental change in the “legal balance of power” in banking and the nationalization of the marketplace for retail banking products. Congress quickly recognized the destabilizing effect of *Marquette* on the dual banking system and the need to provide parallel federal statutory preemption for state banks as an essential means of preserving the dual banking system.

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50. *Id.* at 20.

51. *See, e.g.*, Wachovia v. Burke, Civ. Action No. 3:03 CV 0738 (JCH) (Aug. 26, 2003); *See also* Todd Davenport, *An Issue’s Moment of Truth? A Complex History and an Uncertain Future*, AM. BANKER, Jan. 28, 2004, at 1 (quoting New York Attorney General Eliot Spitzer as saying, “We will litigate [the OCC preemption rule] if need be, but it is certainly an issue that has to be debated in the halls of Congress”).

52. *See generally Marquette*, 439 U.S. 299 (1978) (allowing exportation of home state interest rates).

A. *Background: Providing Products and Services In the Bank's Home State to Out-of-State Customers*

Branching law has strictly regulated where a bank may transact business (e.g. take deposits, make loans) and has limited banking transactions to the bank's main or branch offices.<sup>53</sup> For banks, geographic location long has been an important legal concept. Until the enactment of interstate branching in Riegle-Neal I, all banks could transact such "core" banking business only at authorized bank locations in the bank's home state.

A bank that has no interstate branches may issue credit cards or provide other banking products by national advertising and direct solicitation to customers in other states, through agents, loan production offices, or other means not involving a branch office. Decisions with respect to customer applications are made in the bank's home state at its office, and, for example, the bank's credit cards are issued in its home state. Customer payments are made by mail to the bank in its home state, and payments to the merchants at which the customer used its bank credit card are disbursed from its home state. Moreover, under freedom of contract principles a consumer residing outside of the bank's home state is able to enter into an agreement with the bank that conforms to the law of the bank's home state (and applicable federal law), rather than the law of the customer's state.

Under traditional contracts choice of law principles, this structure supports the general view that all bank transactions take place in the bank's home state under home state law. However, choice of law principles also recognize that host state constitutional or statutory provisions expressing a "vital state interest" may be given effect even though a contractual relationship involving a resident of that state was not established there. Historically, state usury laws have been viewed as embodying such a vital interest.

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53. See e.g. 12 U.S.C. §§ 36, 1813(o), 1828(d) (2001). Indeed, since loans and extensions of credit must be made only at an authorized main or branch office of an insured bank, a state bank could not lawfully make an extension of credit "in" another state except at such an office or branch. See 12 U.S.C. §§ 1813(o) (2001) (defining "domestic branch"), § 1828(d) (2001) (application requirement).

Given these principles and charter limitations, state and national banks for many decades have structured customer relationships and transactions to take place at a main or home state branch banking office. With the increase in the volume of interstate delivery of financial services, the interpretation of the NB Act § 85<sup>54</sup> in *Marquette* to preempt such state laws governing interest rates was critical to the development of national consumer credit markets. The immediate effect was to disadvantage state banks.

*B. The Marquette Case: National Bank Exportation of Interest Rates under § 85 Preemption*

The specific question in *Marquette* concerned the “location” for § 85<sup>55</sup> purposes of a national bank based in Omaha, Nebraska, providing credit cards to Minnesota residents. In its analysis the Court considered whether the manner in which the lending bank conducted its business in the host state might mean that the bank should be deemed to be “located” in that state. The State of Minnesota argued that the Nebraska bank should be deemed to be located in Minnesota because the bank “systematically solicits Minnesota residents for credit cards to be used in transactions with Minnesota merchants.”

The facts stipulated in that case laid out plainly how the Nebraska bank’s business was structured to take place in that state with limited contacts in Minnesota,<sup>56</sup> and the Court determined

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54. 12 U.S.C. § 85 (2001).

55. Section 85 of the National Bank Act provides, in pertinent part:

Any association may take, receive, reserve, and charge on any loan or discount made . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under [title 62 of the Revised Statutes].

12 U.S.C. § 85.

56. See *Marquette*, 439 U.S. at 312-13.

that the locus of the banking transaction corresponded with the designated charter location of the bank:

Omaha Bank cannot be deprived of this location merely because it is extending credit to residents of a foreign State. Minnesota residents were always free to visit Nebraska and receive loans in that State. It has not been suggested that Minnesota usury laws would apply to such transactions. Although the convenience of modern mail permits Minnesota residents holding Omaha Bank's BankAmericards to receive loans without visiting Nebraska, credit on the use of their cards is nevertheless similarly extended by Omaha Bank in Nebraska by the bank's honoring of the sales drafts of participating Minnesota merchants and banks. Finance charges on the unpaid balances of cardholders are assessed by the bank in Omaha, Neb., and all payments on unpaid balances are remitted to the bank in Omaha, Neb. Furthermore, the bank issues its BankAmericards in Omaha, Neb., after credit assessments made by the bank in that city.<sup>57</sup>

The *Marquette* Court's factual discussion construed the term "located" in § 85 based on a contacts analysis. It took seriously the Minnesota argument that the locus of the bank's transactions could affect the location of the bank for § 85 purposes and looked at the particular manner in which the bank did its business to determine that the credit card transactions at issue took place in Nebraska.<sup>58</sup> The single fact that the location designated in the bank's charter was Nebraska was not dispositive of its "location" in this context. However, the Court clearly recognized the nature of interstate banking business when it

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57. *Marquette*, 439 U.S. at 310-12 (footnote omitted).

58. See Darrell L. Dreher, Hugh M. Hayden & Michael C. Tomkies, *Developments in the Interstate Delivery of Consumer Financial Services*, 50 BUS. LAW. 1093, 1104-07 & nn.108-25 (1995).

stated: “If the location of the bank were to depend on the whereabouts of each credit card transaction, the meaning of the term ‘located’ would be so stretched as to throw into confusion the complex system of modern interstate banking.”<sup>59</sup>

The *Marquette* case resolved a question on which courts had previously split<sup>60</sup> by definitively determining that a national bank was not subject to host state usury law. By permitting national banks to lend interstate by exporting their home state usury regime, *Marquette* confirmed the supremacy of § 85 over state usury law outside the lender-national bank’s home state. It thus validated the ability of national banks to issue credit cards and lend nationally without interstate branches from their home state locations and created an obvious competitive imbalance favoring national banks over states banks and thrifts.

### C. *Implications of Marquette*

Beyond the particular construction of § 85, the discussion in *Marquette* is a persuasive illustration of a contract choice of law analysis supporting the broad conclusion that the bank in question was not only “located” in its home state for § 85 purposes, but also entered into its loan contracts and transacted its business there. In order to export the interest rate, the bank must be able to enter into a valid loan in its home state with a customer in another state. *Marquette* thus implicitly validates the bank’s ability to make the loan and undercuts the ability of the host state to apply its law to other aspects of the transaction. The Court did not say that the lending bank in that case was located in Nebraska simply because its charter designated that state as its legal place of business. Rather, the Court determined that the bank was located where it transacted its business.

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59. *Marquette*, 439 U.S. at 312.

60. As summarized in the *Marquette* decision, the Minnesota trial court in that case had held that the Nebraska bank’s credit cards were subject to Minnesota usury provisions, a result reached by the Iowa Supreme Court in a parallel case. *Id.* at 305, 307 n.17. The U.S. Courts of Appeals for the Seventh and Eighth Circuits, on the other hand, had held that the NB Act did preempt host state law. *Id.* at 306 & n.16.

*Marquette*'s significance goes beyond its holding, and the case appears in many ways to have become the archetype for the model that a bank may provide products to customers in other states from its home state office and on the terms provided in its charter law. The legislative history of Riegle-Neal specifically reflects the general acceptance of the structure discussed in *Marquette* in which banks can engage in multi-state business through contracts legally made at its home state location under its charter law.

*Marquette* gave important impetus to multi-state banking by establishing firmly the principle under § 85 that a national bank may "export" its home state usury regime to customers throughout the country.

*D. Federal Preemption for State Banks Under the Parity Provision of § 27*

State-chartered banks had no specific statutory basis to assert that they could similarly lend across state lines on a uniform basis. Thus, state banks remained subject to the possibility that host state usury law would apply when they issued credit cards or otherwise extended credit to customers outside their home states. To correct this disparity, two years after *Marquette*, § 27 of the Federal Deposit Insurance Act (FDIA)<sup>61</sup> was enacted as an interstate usury statute for state banks' parallel to § 85.<sup>62</sup> The § 27

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61. 12 U.S.C. § 1831d (2001).

62. § 27(a) of the FDIA substantively tracks § 85 of the NB Act and states:

In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is

statutory language was drafted to mimic § 85 so that the results for state banks would match the operation of § 85 for national banks. Congress used this drafting approach to ensure that parity for state banks would result. In doing so, Congress implicitly affirmed the analytical framework used by the Court in *Marquette*.

In *Greenwood Trust Co. v. Massachusetts*,<sup>63</sup> the First Circuit Court of Appeals confirmed this parity. The court held that § 27 of the FDIA and § 85 of the NB Act are to be construed *in pari materia* because § 27 is patterned after § 85, their provisions embody similar terms and concepts, and Congress clearly intended to establish competitive equality between state-chartered lending institutions and national banks with regard to interest rates by enacting § 27. “Congress tried to level the playing field between federally chartered and state chartered banks” when it enacted the express federal preemption contained in § 27.<sup>64</sup> Subsequently, the General Counsel of the FDIC issued an opinion to the same effect.<sup>65</sup>

Section 27 restored balance to the dual banking system and provided an express Congressional validation of a national policy favoring uniform rules in interstate banking for both state and national banks and that a preemptive federal regime can look to state law, in this case, the law of the state where the national or state bank is “located.”

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located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.

12 U.S.C. § 1831d(a).

63. *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993).

64. *Greenwood*, 971 F.2d at 826. In *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735 (1996), the Supreme Court subsequently addressed parallel substantive issues concerning “interest” under the NB Act.

65. FDIC General Counsel’s Opinion No. 10; Interest Charges Under Section 27 of the Federal Deposit Insurance Act, 63 Fed. Reg. 19,258 (April 17, 1998).

#### IV. PREEMPTION AND PARITY FOR STATE BANKS UNDER THE RIEGLE-NEAL ACT, AS AMENDED

##### A. *The Riegle-Neal Watershed*

By the 1990s, a multi-state, even national, marketplace for financial services was well established. Multi-state, multi-bank bank holding companies were commonplace, as was direct delivery of retail and wholesale banking products and services across state lines. In this context, Riegle-Neal must be seen as fundamental and historic on more than one level. Most obviously, it authorized interstate brick-and-mortar branches. It thus reversed a cornerstone provision of federal banking policy dating to the Jackson Presidency over 150 years earlier. However, Riegle-Neal means far more than additional brick-and-mortar locations.

In fashioning the legal framework for multi-state banks, Congress had to consider the entire framework of rules governing interstate banking. Indeed, once the rules regarding how and where to effect interstate branching were largely agreed upon, an extended discussion about “applicable law” took place among Congressional leaders and staff, the Administration, banking representatives, consumer/public interest groups, and state governmental interests. Determining the state or federal law applicable to interstate branches necessarily entailed consideration of the law applicable to the bank as a whole because branches are not distinct legal entities, but extensions of a single bank operating under a single bank charter.

Taken as a whole, Riegle-Neal represents a new federal framework governing multi-state banking, a confirmation that banking was no longer a *local activity*, but a national activity in a mobile, nationwide economy, in which funds are often obtained and priced on national financial markets and credit extended to customers on a multi-state basis. Riegle-Neal thus should not be viewed as dealing only with interstate bricks-and-mortar, but as an explicit federal policy for banking as a multi-state economic activity conducted by state and national banks. For banks in the post-Riegle-Neal world, federal preemption is a necessary



corollary to interstate banking that allows a bank with interstate branches to operate as a single integrated business unit.

*B. The Three Distinct Components Of Riegle-Neal I*

Riegle-Neal I dealt comprehensively with interstate banking in a national context, including interstate bank acquisitions, interstate branching, and the law applicable to interstate institutions:

- It replaced the Douglas Amendment to the Bank Holding Company (BHC) Act with a uniform federal policy permitting interstate acquisition of banks by BHCs without reference to state law;<sup>66</sup>
- It established for the first time federal rules permitting interstate branching for all insured banks (national and state); it reversed national policy dating from the Jackson era that the states should determine where banks may establish branches;<sup>67</sup> and
- The statute includes a federal preemption rule determining the extent to which host state law might apply to activities of both national and state banks with interstate branches. For national banks, the statute preserved intact the existing scope of preemption under the NB Act so that national banks would continue to operate both directly and through branches under the uniform terms of the NB Act. Riegle-Neal I strictly limited the instances in which state law might apply to a national bank – that is, only four types of host state laws could apply to interstate national bank branches and then only to the extent they were not otherwise preempted by the NB Act. Riegle-Neal I did not provide parity for state banks: it determined as a matter

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66. See 12 U.S.C. § 1842(d) (2001).

67. 12 U.S.C. §§ 36(g), 1828(d)(4)(A), 1831u(a)(4)(A), 1831u(g)(6) (2001).

of federal law that host state law would generally apply to state bank interstate branches.<sup>68</sup>

C. *The Riegle-Neal “Applicable Law” Framework for National Banks*

Riegle-Neal I made national bank interstate branches subject to host state law in four specified areas – consumer protection, community reinvestment, fair lending and location of intrastate branches (the so-called “Big Four”) – *unless* the state law in any of these four areas would be preempted by federal law.<sup>69</sup> Indeed, despite the surface deference to the “Big Four,” this provision in effect restates existing law: only state laws that are not preempted apply to national banks. This provision thus has the principal effect of designating which particular state law might apply when the NB Act does not preempt.

The broad reach of the federal preemption “exception” means that these ironically labeled “Big Four” host state provisions have far less reach than it might seem on a first reading. In reality, interstate branches of national banks are subject to the NB Act to the same extent as home state branches are, and Riegle-Neal I does not appear to have made national bank interstate branches subject to host state laws to any greater extent than a national bank based in that host state would be subject to that state’s law. Riegle-Neal I also plainly did not provide any basis for a host state to assert that state law rather than the NB Act should apply to the direct activities of a national bank in a host state.

### 1. Legislative History

The statement of Senator William Roth (R-Del.), a leading architect of Riegle-Neal I, supports the view that the same law is to apply throughout a bank (except to the extent that the “Big Four” are not preempted and thus a non-preempted state law otherwise provides):

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68. *Cf.* 12 U.S.C. § 36(f) (discussing the law applicable to interstate branching operations to national bank branches).

69. *See* 12 U.S.C. § 36(f)(1)(A) (2001).

[I]t is clear that the conferees intend that a bank in State A that approves a loan, extends the credit, and disburses the proceeds to a customer in State B, *may apply the law of State A* even if the bank has a branch or agent in State B and even if that branch or agent performed some ministerial functions such as providing credit card or loan applications or receiving payments.”<sup>70</sup>

Accordingly, for national banks, Riegle-Neal I provides that the scope of federal preemption for national banks is the same throughout a multi-state bank in all its direct activities with customers in other states, and in both its home state and out-of-state branches. The NB Act applies uniformly to the entire national bank, and state law in the “Big Four” areas apply to both home and host state branches according to location, but *only* if the NB Act does not apply. Thus, although the Riegle-Neal language is couched in terms of host state law applicable to out-of-state branches, it states in substance a uniform national rule governing national bank branches/activities wherever they take place.

The states understand this regime. Although the terms of the post-1997 CSBS Nationwide Cooperative Agreement (the “Agreement”) are written to give apparent emphasis to the “Big Four,” the Agreement states that the same law applies to all branches in host states, both state and national<sup>71</sup>:

Section 6.1. Host State Law.

Host state law that applies to the operations of a branch established in the host state by an out-of-state national bank, shall apply to the operations of a host state branch of a multi-state bank, including:

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70. 140 CONG. REC. S12785, S12789-790 (daily ed. Sept. 13, 1994) (emphasis added). In this statement, Sen. Roth refers broadly to the “law of State A,” not just State A’s usury law. *Id.* (on file with the NCBI).

71. Conference of State Bank Supervisors Nationwide Cooperative Agreement (1997), *available at*, [http://www.csbs.org/government/agreements/pdf/nationwide\\_coop\\_agrmt.pdf](http://www.csbs.org/government/agreements/pdf/nationwide_coop_agrmt.pdf) (last visited Feb. 13, 2004).

(i) antitrust law and deposit concentration limits; (ii) community reinvestment and similar laws; (iii) consumer protection laws, including lending and usury laws to the extent that laws or court decisions regarding the exportation of interest rates are inapplicable; and (iv) fair lending or equal credit laws. . . .

## 2. Significance of Riegle-Neal

For all banks, Riegle-Neal represents an express Congressional re-assertion of its authority to regulate interstate commerce engaged in by FDIC insured banks with state or national charters. Riegle-Neal, including the 1997 Amendments, represents a thorough Congressional policy with respect to interstate banking and branching in this country that is grounded in both the Commerce and Supremacy clauses of the U.S. Constitution.

The detailed and comprehensive nature of the Riegle-Neal framework with respect to interstate branching by all insured banks supports the view that this legislation occupies the field with respect to interstate banking and provides a uniform legal framework applicable to state and national banks engaged in interstate banking.<sup>72</sup> We are not aware that any court to date has been asked to view Riegle-Neal as preempting the field, but the comprehensiveness of the Congressional consideration and final statute support this view.

### *D. Applicable Law for State Banks Under Riegle-Neal I: Disparity for State Banks*

Riegle-Neal was not silent with respect to multi-state state banks and did not leave it to the several states to determine how to

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72. Cf. *Fidelity Federal Savings and Loan Assn. v. de la Cuesta*, 458 U.S. 141 (1982) (holding that federal regulation may be so pervasive that one may reasonably infer that Congress left no room for states to supplement it); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 822-23 (1st. Cir. 1992) (discussing preemption principles).

treat state bank branches. Rather, it stated a *federal rule* that incorporated the substantive law of each host state. As with the earlier Douglas Amendment to the BHC Act, the choice to look to the substance of state law does not make the statute any less a federal rule. In 1994, as requested by the state banking regulators represented by CSBS, Riegle-Neal I made host state law applicable to out-of-state branches of state banks.<sup>73</sup>

CSBS took that position in 1994, even though a group of major state banks argued that it would place state banks with interstate branches at a substantial disadvantage vis-à-vis their national bank competitors. In contrast to the efficiency of a multi-state national bank operating almost entirely under the NB Act, state banks would have to bear the burden and expense of ensuring that their branches in host states conformed to each host state's law across the board.

Once Riegle-Neal became law, state regulators realized that the interstate disparity it created might seriously undermine the state system and thus the dual banking system. Within two years, CSBS reversed its position and began to seek parity in interstate banking.

*E. Riegle-Neal II – A New Federal Preemption Rule for State Banks*

After the legal barriers to interstate branching were removed, CSBS recognized that a more seamless uniform state system that paralleled the national system under Riegle-Neal would be essential to the long-term vitality of the state banking system in a multi-state or national environment. Parallel to the development of its National Cooperative Agreement concerning supervision of multi-state banks, CSBS took the lead in seeking amendments to Riegle-Neal to provide the necessary legal parity in a federal statute for state banks. The result was Riegle-Neal II, a 1997 amendment to Riegle-Neal I that mimicked the Riegle-Neal I “applicable law” language for national banks to provide a

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73. See 12 U.S.C. § 1831a(j) (2001).

parallel federal preemption permitting state banks to operate interstate under home state law.<sup>74</sup>

### 1. Legislative History

Riegle-Neal II was passed by the House, amended in the Senate, and then passed as amended by the House. The legislative history is sparse because there are no committee or conference reports. Nevertheless, the purpose to provide state-national parity is made plain by its sponsors, proponents, and opponents. The only question is the scope of that parity.

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74. See 12 U.S.C. § 1831a (2001). The language of the 1997 amendments directly and intentionally mimics the original Riegle-Neal “applicable law” language for national banks. As amended in 1997, the pertinent provisions of 12 U.S.C. § 1831a are:

(j) **ACTIVITIES OF BRANCHES OF OUT-OF-STATE BANKS**

(1) **APPLICATION OF HOST STATE LAW**

The laws of a host State, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch in the host State of an out-of State national bank. To the extent host State law is inapplicable to a branch of an out-of-State State bank in such host State pursuant to the preceding sentence, home State law shall apply to such branch.

(2) **ACTIVITIES OF BRANCHES**

An insured State bank that establishes a branch in a host State may conduct any activity at such branch that is permissible under the laws of the home State of such bank, to the extent such activity is permissible either for a bank chartered by the host State (subject to the restrictions in this section) or for a branch in the host State of an out-of-State national bank.

(3) **SAVINGS PROVISION** – No provision of this subsection shall be construed as affecting the applicability of –

(A) any State law of any home State under subsection (b), (c), or (d) of [section 44 of the FDIA]; or

(B) Federal law to State banks and State bank branches in the home State or the host State.

*Id.*

In the Senate, Banking Committee Chairman Alfonse D'Amato (R-N.Y.) summarized the rationale for the bill as follows:

[T]he trigger date for nationwide interstate branching has passed—June 1, 1997. This important legislation will preserve the benefits of the dual banking system and keep the state banking charter competitive in an interstate environment. . . .

Mr. President, the dual banking system is under attack. The bill is necessary to preserve confidence in a state banking charter for banks with such a charter that wish to operate in more than one state. In addition, it will curtail incentives for unnecessary Federal preemption of State laws. Finally, the bill will restore balance to the dual banking system by ensuring that neither charter operates at an unfair advantage in this new interstate environment. . . .

New York has more than 90 State[-]chartered banks . . . . Without this legislation, the largest of these institutions may be tempted to convert to a national charter in order to operate in more than one State. . . .

The current law may be unclear as to whether consistent rules are used to determine what laws and powers apply to the out-of-state branches of state and federally chartered banks . . . . [Summary of the bill's terms omitted]

Enactment of H.R. 1306 also would bolster efforts of New York and other states to make sure that State[-]chartered banks have the powers they need to compete efficiently and effectively in an interstate environment.

Mr. President, this bill is especially important now because of the efforts of the Comptroller of the Currency to preempt state laws and promote the national charter at the expense of the States and other Federal regulators . . . . [T]he OCC has

mounted an unprecedented, aggressive marketing effort to convince State chartered banks to flip to a national charter.<sup>75</sup>

When the bill was submitted for final passage, the lead sponsor of Riegle-Neal II in the House, Rep. Marge Roukema (R-N.J.), stated:

This bill had strong bipartisan support and clarifies the ambiguities of the Riegle-Neal interstate bill and preserves the dual banking system by allowing an out-of-state branch of a state bank to offer the same products allowed in its home state as long as the host state banks or national bank branches . . . may exercise those same powers.

In addition, the bill provides that the host state law will apply to those out-of-State branches to the extent it also applies to national banks. . . .[summary of several amendments made in the Senate omitted]

H.R. 1306's intent is to provide parity between national and State chartered banks in an interstate environment as well as ensure the viability of the dual banking system is unaffected by the Senate's changes . . . .<sup>76</sup>

## 2. Parity With National Banks Based on Home State Law

The 1997 Amendments changed the content of the original Riegle-Neal framework and established a federal law basis for state banks to operate host state branches based upon home state law, with an overlay of federal regulation and supervision. Riegle-Neal II established the model for state banks to achieve a uniformity parallel to the NB Act. Specifically, the 1997 Amendments provide parity for state banks through a *federal* statute that preempts state law under the Supremacy Clause the

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75. 143 CONG. REC. S5,637, S5,637 (daily ed. June 12, 1997).

76. 143 CONG. REC. H4230 (daily ed. June 24, 1997).



same as does any other federal statute. The amendments specify that home state law will apply to interstate branches of state banks, except that host state law will apply to state bank interstate branches in the “Big Four” areas to the same extent as those host state laws apply to national banks – that is, only to the extent such state laws are not preempted for national banks.

The intended scope of Riegle-Neal II bears careful consideration in the context of its legislative history. It clearly provides parity treatment for interstate branches of a state bank. But the Congressional leaders also recognized the broader effect of OCC preemption on the dual banking system in the new era of interstate banking. There is legislative history that may be read to support the view that Riegle-Neal II provides a basis for federal preemption potentially applicable to all the business and activities of state banks. The argument in favor of this broader view has the following elements:

- Riegle-Neal II is specifically drafted to mimic the Riegle-Neal national bank applicable law language that was clearly intended to insure that the NB Act applied uniformly to all the activities of a national bank both in its home state and in other states, whether through branch offices or direct dealing with out-of-state customers. Riegle-Neal accepted the NB Act structure as then understood and modified it only to provide an express framework for the applicability of host state law to a new feature of the national bank system, interstate branch offices.
- There is basis in the Riegle-Neal II legislative history for an intention by Congress to support the dual banking system in an interstate environment in which national banks are supported by broad federal preemption and to provide parity to state banks. Moreover, in the Senate particularly there was concern that the aggressive development of federal preemption for national banks was further disadvantaging state banks. Chairman D’Amato suggested that state bank

parity would reduce the incentive for the OCC to be so aggressive in promoting federal preemption.

- To provide parity for state banks in a multistate environment, Riegle-Neal as amended in 1997 may be read as stating that both national and state banks can do business across the country under their charter law (NB Act and home state law, respectively) with the proviso that business transacted at host state branches of both national and out-of-state banks will be subject to host state law only to the extent it survives the NB Act preemption standard as provided in the “Big Four” exception.
- The 1997 Amendments thus may be read to provide the same federal law basis for home state law to apply by its terms to all transactions of a state bank. Under this approach the home state law of a state bank should be equally applicable as the NB Act is for national banks, wherever they do business in the country (subject only to the “Big Four” proviso in out-of-state branches).

The logic of this outcome is suggested by the following example: Under Riegle-Neal II, if a Tennessee bank makes a loan to a customer in Kentucky through its branch in Kentucky, Tennessee law is unquestionably applicable to that loan. If the same bank makes the same loan to the same Kentucky customer from its home office in Tennessee (or through an operating subsidiary), should Kentucky law apply? Or should Tennessee law also apply, as when the loan is made through the branch in Kentucky? Given the logic — and parity — of Tennessee law applying in both instances and the legislative history concerning the potentially adverse effects of national bank preemption on the dual banking system, the use of language in Riegle-Neal II that mimics the national bank “applicable law” provision might support a determination (by the FDIC, for example) that the full parity suggested by this example may be implied from the enactment of Riegle-Neal II.

### 3. National Banking Policy in Riegle-Neal I and II

Riegle-Neal, as amended, may be seen as establishing a federal banking law/regulatory framework to correspond to a nationwide banking marketplace. Parallel to § 27, Riegle-Neal II provided a federal basis for a state bank with interstate branches to “export” its home state law and operate under a uniform multistate regime. Given Congressional understanding of bank needs in today’s marketplace and the scope of possible federal preemption of national banks, it may be possible to view Riegle-Neal as embodying a general federal policy that the law of a bank’s state or national charter authority should govern all its activities wherever conducted in this country, subject to the limited, express “Big Four” exception justified by the presence of a branch in a host state and applicable only in such a host state, and then only to the extent to which that law is not preempted under the NB Act. The limited scope of these exceptions thus reinforces the conclusion that Congress recognized that bank branches are not legally distinct entities, but additional physical locations that operate under the same charter as the rest of the bank, and that Congress correspondingly endorsed a general policy that all banks are to be generally subject to one body of banking law wherever they do business across the country.

#### *F. A Note About Marquette/Section 27 in Light of Riegle-Neal*

Conceptually, the Riegle-Neal preemption is broad enough to subsume the existing § 85 and § 27 usury preemption regime. Nevertheless, Congress determined to preserve and recodify the *Marquette* usury regime explicitly.

The retention of the pre-Riegle-Neal *Marquette* framework parallel to the new interstate regime is supported by Riegle-Neal and its legislative history. Proponents of interstate branching also wanted to ensure that Riegle-Neal would in no way undermine home state interest charge exportation under § 85 and § 27. To this end, § 111(3) of Riegle-Neal expressly affirmed *Marquette* by stating that nothing in the new act shall be construed as affecting the applicability of § 85 or § 27. The explanation of this provision

by its chief proponent goes beyond the specific issue of exportation of interest charges to clarify the home state exportation model itself.<sup>77</sup> Accordingly, if a transaction is structured to take place at a home state office, the legal location of the transaction will not be changed by the fact that the bank may operate a branch in the (host) state where the customer resides.

According to Sen. Roth, the export regime codified by Riegle-Neal does not rest on simple exportation of home state usury law, but incorporates a functional approach based upon where the loan is made. The locus is effectively determined by where three “nonministerial” functions take place: where the credit decision is made, where the extension of the credit takes place, and where the loan funds are disbursed. Accordingly, if a loan is made in the home state, home state law governs (regardless of where the customer resides or whether certain “ministerial” activities have occurred in the host state); and, if the loan is made in a branch in the host state, then host state law applies. This framework has been recognized and implemented by the banking agencies interpreting Riegle-Neal.<sup>78</sup>

The difference between § 85/*Marquette*/§ 27 and the general approach to federal preemption is reflected in federal banking regulations, which treat the interest charge preemption issues raised by those provisions distinct from the broader range of preemption questions. The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) regulations include specific provisions addressing interstate interest charges but take the position that virtually all other questions concerning interstate lending are dealt with under general preemption principles.<sup>79</sup>

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77. See 140 CONG. REC. S12,785, S12789–790 (daily ed. Sept. 13, 1994).

78. See FDIC General Counsel’s Opinion No. 11, Interest Charges by Interstate State Banks, 63 Fed. Reg. 27,282 (May 18, 1998).

79. Compare 12 C.F.R. § 7.4001 (addressing interest charges under § 85), with § 7.4002 (non-interest charges are addressed under preemption principles), and 12 C.F.R. § 560.2 (“applicability of law” — preemption — in general), with § 560.110 (most favored lender usury preemption).

## V. PREEMPTION FOR DEPOSITORY INSTITUTIONS AND THEIR FINANCIAL AFFILIATES UNDER § 104 OF THE GLBA

Congress provided further express federal preemption in support of a national financial services marketplace in the Gramm-Leach-Bliley Act (GLBA) in 1999. Section 104 of this legislation provides express federal preemption for an unprecedented range of beneficiaries: not only all federally insured banks and thrifts, but also all “financial” subsidiaries and affiliates of insured depository institutions. Under § 104, any state law that is discriminatory or burdensome (as defined) for any such entity is preempted.<sup>80</sup> As discussed below, § 104 also has specific application in support of interstate parity for state banks.

### A. *Background*

Section 104 arose out of concern with the laws of many states that sought to prevent or burden bank-insurance affiliations. Many of the detailed and complex provisions of § 104 reflect the lengthy and difficult negotiations among bank and insurance groups to fashion acceptable language. Section 104 resolved longstanding differences between banking and insurance interests and was a political linchpin of GLBA. After this treaty was worked out to preempt protectionist state insurance provisions, additional parallel language was added to provide similar protection to financial organizations with respect to state provisions that adversely affect the terms of competition for all banks and their financial subsidiaries and affiliates.

The reports of both the Senate Banking Committee and House Commerce Committee, the committees that had the primary roles in drafting § 104, make plain their intent to ensure that state laws would not stand in the way of continued development of a nationwide “level playing field” in the financial services marketplace. The Senate Banking Committee took the lead role in fashioning § 104 in the form ultimately enacted and expressly addressed its purpose in its Report:

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80. 15 U.S.C. § 6701(e) (2001).

[T]he Committee is aware that some States have used their regulatory authority to discriminate against insured depository institutions, their subsidiaries and affiliates. The Committee has no desire to have State regulation prevent or otherwise frustrate the affiliations and activities authorized or permitted by this bill. Thus, § 104 clarifies the application of State law to the affiliations and activities authorized or permitted by the bill (or other Federal law), and ensures that applicable State law cannot prevent, discriminate against, or otherwise frustrate such affiliations or activities.<sup>81</sup>

The House Commerce Committee specifically focused on the language concerning non-insurance financial affiliations. Its Report states:

The purpose of . . . [the Act] is to establish a comprehensive framework to permit affiliations among securities firms, insurance companies, and commercial banks. The primary objective of allowing such affiliations is to enhance consumer choice in the financial services marketplace, eliminate anti-competitive regulatory disparities among financial services providers, and increase competition among providers of financial services.<sup>82</sup>

For banks, the starting point in their negotiation was the preemption analysis followed by the U.S. Supreme Court in a series of cases over many decades, most recently *Barnett Bank v. Nelson* in 1996.<sup>83</sup> That case stated that a state law would be preempted by the NB Act if it impeded, prevented, or significantly interfered with the conduct of activities permitted to national banks, in this case small-town insurance agency activities.

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81. S. REP. NO. 106-44, at 11 (April 28, 1999) (Senate Banking Committee).

82. H.R. REP. NO. 106-74, pt. 3, at 98 (June 15, 1999); *Accord*, S. REP. NO. 106-44, at 4-6 (April 28, 1999) (Senate Banking Committee); H.R. REP. NO. 106-74, pt. 1, at 97 (March 23, 1999) (House Banking Committee).

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

## B. Provisions of § 104

Subsections 104(a) and (b) simply restate the continued force of the McCarran-Ferguson Act and the requirement that all persons engaged in the “business of insurance” in a state must be licensed as provided by that state’s law.<sup>84</sup> Subsection 104(c) provides for federal preemption to ensure the ability of depository institutions to establish affiliations or associations with insurance firms, while maintaining the ability of state insurance regulators to review new insurance affiliations on a nondiscriminatory basis. Subsections 104(d) and (e) are the heart of the section’s preemption framework. These provisions are relatively complex and must be read together. Finally, under Subsection 104(f) state law concerning corporate governance, antitrust, and securities registration and antifraud enforcement are expressly protected from preemption under § 104.

### 1. Financial Activities

At the threshold, § 104(d)(1) states a broad federal preemption rule covering *all activities of a depository institution and its financial affiliates*. It reaches any state law or action that would “prevent or restrict” an insured depository institution, or affiliate thereof, from “engaging directly or indirectly, either by itself or in conjunction with an affiliate, or any other person” in any financial activity. State law or actions concerning *activities other than insurance* are also made subject to a four-part nondiscrimination test in paragraph (d)(4).<sup>85</sup>

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84. See 15 U.S.C. § 6701(a)(b) (2001).

85. 15 U.S.C. § 6701(d)(4) states, in pertinent part:

No State statute, regulation, order, interpretation, or other action shall be preempted under paragraph (1) to the extent that—

(A) it does not relate to, and is not issued and adopted, or enacted for the purpose of regulating, directly or indirectly, insurance sales, solicitations, or cross marketing activities covered under paragraph (2);

(B) it does not relate to, and is not issued and adopted, or enacted for the purpose of regulating, directly or indirectly, the business of insurance activities other than sales, solicitations, or cross marketing activities, covered under paragraph (3);

(C) it does not relate to securities investigations or enforcement actions referred to in subsection (f); and

## 2. Insurance

Insurance sales activities are governed by § 104(d)(2).<sup>86</sup> State rules or actions concerning insurance sales, solicitation, or cross-marketing are subject to the detailed, and often ambiguous, provisions of this section. Paragraph (d)(2) provisions governing such state insurance sales activities are especially complicated: they include a multi-part general rule and two significant exceptions. The general rule subjects state legislation affecting insurance sales activities to several tests: a “prevent or significantly restrict” test “in accordance with” *Barnett*, and four “nondiscrimination”<sup>87</sup> tests. It further provides that disputes between banking and insurance regulators are litigated under special procedures set forth in GLBA § 304 subject to a “without unequal deference” standard of review.

In response to insurance group concerns that the four new “nondiscrimination” tests in subsection (e) would invalidate existing laws that (they believed) could survive scrutiny under the *Barnett* case standards, certain specific exceptions were included in

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(D) it—

(i) does not distinguish by its terms between depository institutions, and affiliates thereof, engaged in the activity at issue and other persons engaged in the same activity in a manner that is in any way adverse with respect to the conduct of the activity by any such depository institution or affiliate engaged in the activity at issue;

(ii) as interpreted or applied, does not have, and will not have, an impact on depository institutions, or affiliates thereof, engaged in the activity at issue, or any person who has an association with any such depository institution or affiliate, that is substantially more adverse than its impact on other persons engaged in the same activity that are not depository institutions or affiliates thereof, or persons who do not have an association with any such depository institution or affiliate;

(iii) does not effectively prevent a depository institution or affiliate thereof from engaging in activities authorized or permitted by this Act or any other provision of Federal law; and

(iv) does not conflict with the intent of this Act generally to permit affiliations that are authorized or permitted by Federal law.

86. 15 U.S.C. § 6701(d)(2) (2001 & Supp. 2003).

87. See § 6701(e).



the final rule. Under the compromise, “Old Law” (statutes, rules, or actions in force on September 3, 1998) is made subject only to the “prevent or significantly restrict” test and not the “nondiscrimination” tests. However, a proviso exists. In cases involving Old Law, the courts would continue to accord deference to the federal banking agencies under the *Barnett* and *Chevron* cases. A second, so-called “safe harbor” exception covered thirteen specified types of state rules that are protected from preemption under the general rule as long as they conform to detailed federal standards set forth in § 104 (d)(2)(B). Under paragraph (d)(3), nonsales insurance activities (e.g., chartering and regulation of insurance underwriters and licensing and general regulation of agents and brokers) are subjected to a set of broad “nondiscrimination” tests under subsection (e).

C. *Preemption Under GLBA § 104 for the Benefit of State Banks*

Although the original impulse behind § 104 arose from state insurance laws designed to prevent banks from having insurance affiliates, its language as finally enacted reaches potentially any state law barring or interfering with the provision of financial services in that state by any bank or any financial affiliate of a bank. Indeed, § 104 may be viewed as a further express statement of a national policy to establish a national, competitive marketplace for banking and financial services and to prevent state law from favoring some competitors over others. This section is very broadly worded and its language can be read comfortably to address and thus preempt burdensome or discriminatory state laws as applied to state banks and their affiliates. This result is supported by the language of § 104 and should not be undercut by the lack of evidence that the drafters of § 104 specifically contemplated its application to host state laws that disadvantage or place greater requirements on out-of-state banks compared to in-state banks or national banks.

The literal terms of § 104(d)(1) state a federal preemption rule covering *all banking and financial activities of a depository institution and its affiliates*. It reaches any state law or action that

would “prevent or restrict a[n] [insured] depository institution, or affiliate thereof, from “engaging directly or indirectly, either by itself or in conjunction with an affiliate, or any other person” in any financial activity.<sup>88</sup> The broad (d)(1) “prevent or restrict” rule is given further gloss in paragraph (d)(4), which subjects state law or actions concerning activities other than insurance to four separate nondiscrimination tests. Under these provisions, no state may regulate noninsurance financial activities as permitted under GLBA or “any other provision of Federal law” of insured depository institutions or affiliates thereof to the extent that such rule or action:

- (i) “distinguishes by its terms” between depository institutions or affiliated entities and other persons or entities engaged in a financial activity “in a manner that is in any way adverse” with respect to the conduct of the activity by a depository institution or affiliated entity;<sup>89</sup>
- (ii) “as interpreted or applied, has or will have an impact on depository institutions” and affiliated entities that is “substantially more adverse than its impact on other persons” or entities (that are not a depository institution or affiliated entity) engaged in the same activity;<sup>90</sup>
- (iii) “effectively prevents” such a depository institution or affiliated entity from engaging in any activity permitted by GLBA or any other provision of federal law;<sup>91</sup> or
- (iv) “conflicts with the intent” of GLBA and the amendments made by GLBA to allow affiliations permitted by GLBA or other federal law.<sup>92</sup>

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88. § 6701(d)(1).

89. § 6701(e)(1).

90. § 6701(e)(2).

91. § 6701(e)(3).

92. § 6701(e)(4).

These tests are cumulative, and thus a state law, rule, or any other state “action” that runs afoul of any one of these tests is subject to preemption. The tests in subparagraph (i) and (iii) particularly might be applied to interstate banking activities. Subparagraph (i) is a parity provision that addresses state law that “by its terms” deals differently and in an adverse way with two distinguishable groups of persons engaging in the same activity. This provision expressly reaches state law provisions that distinguish between “depository institutions . . . engaged in the activity at issue” and “other persons engaged in the same activity.” The question from an out-of-state state bank’s perspective is whether “other persons” may be read to include another class of depository institutions, and thus whether this provision would preempt, for example, a state statute that imposes requirements or restrictions on out-of-state state banks, but not on in-state banks or federally chartered banks or thrifts.

First, there is no language in subparagraph (i), nor anything in the structure of subparagraph (i), to narrow the breadth of “persons” to exclude depository institutions. Further, there is evidence in the next subparagraph supporting the view that these provisions were carefully drawn and that when Congress wished to distinguish between depository institutions and non-depository institutions, it could do so. In subparagraph (ii), states are barred from having laws that have “an impact on depository institutions . . . that is substantially more adverse than its impact on other persons . . . engaged in the same activities that are not depository institutions . . .”<sup>93</sup>

Subparagraph (i) thus focuses on state laws or other actions that on their face distinguish between a class that includes a depository institution or affiliate and any other class of persons in a way that is “in any way adverse” to the conduct of any activity by a depository institution or affiliate. Subparagraph (ii) contains a “substantially adverse impact” test applicable to laws that affect depository institutions or their affiliates differently from non-depository entities. Congress thus chose to cast a wider net for state laws or actions involving facial discrimination than for ones

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93. 15 U.S.C. §6701(e)(2) (emphasis added).

that are facially neutral but would have an adverse effect only on a depository institution or an affiliate.

Accordingly, subparagraph (i) should apply to a host state that enacts a statute that places burdens on out-of-state banks that it does not place on other persons, *e.g.*, in-state state banks or federally chartered institutions wherever located. For example, this provision would appear to preempt a host state rule or action that would require a state depository institution from another state to receive a license or set up an approved office in the host state before it can provide lending products and services in the host state, but does not seek to apply such requirements to out-of-state federal thrifts or banks. There is the further issue of whether a state statute that purports to reach all federal and state depository institutions but is preempted by the NB Act and HOLA for federal institutions should be preempted under § 104 provisions with respect to state banks (both in-state and out-of-state) because, as construed by the courts, its terms distinguish between federal and state institutions.

Subparagraph (iii) addresses barriers, not discrimination. A state law, other state requirement, or “action” thus may be preempted if it serves as a barrier to entry by a depository institution or affiliate chartered and supervised by another state, and thus an entity that presumptively satisfies legitimate host state regulatory qualifications.

Section 104 has a broad, but largely unexplored sweep. Its stated purpose is not just to remove state barriers to bank insurance activities, but also to overcome state laws, rules, or “actions” that put one type of competitor in financial services — including state banks and their subsidiaries — at a disadvantage vis-à-vis other competitors. This provision seems particularly suited to addressing questions related to state laws that impose requirements on the activities of out-of-state banks and their operating subsidiaries that are not imposed on either in-state depository institutions or national banks and their subsidiaries.

## VI. A CONSTITUTIONAL TOOL: THE “NEGATIVE” COMMERCE CLAUSE

It is well established that “the Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well. The Clause, in Justice Stone’s phrasing, ‘by its own force,’ prohibits certain state actions that interfere with interstate commerce.”<sup>94</sup> The Supreme Court has held that this “negative” commerce clause authority prevents a state from denying entry to an out-of-state financial company.<sup>95</sup> It also should limit the ability of a state to burden or interfere with the activities of a state bank in another state, although cases so holding are rare.<sup>96</sup> In keeping with cases holding that the negative commerce clause bars a state from imposing any tax on an out-of-state company soliciting and providing products to host state customers solely through the mails or other common carriers, a state should be barred from imposing burdens or requirements on direct sales and service activities by an out-of-state bank that has no office or presence in that state and that deals with customers only by means of the mails, telephone or other common carriers.<sup>97</sup>

Such a Commerce Clause argument was made in the brief submitted by the American Bankers Association in a 2002 preemption case (ABA Brief). That suit challenged a California statute imposing significant disclosure and consumer education

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94. *Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992). The authors wish to thank George Sutton of Callister Nebeker & McCullough for calling this case to our attention and for his thoughtful comments on these issues.

95. See generally *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980) (finding state protectionism in this practice).

96. See generally *Carver v. Myers*, 75 Dauph. 129 (Pa. Cty. 1960) (finding undue state burden on interstate commerce).

97. See *Quill*, 504 U.S. at 311:

[W]e will sustain a tax against a Commerce Clause challenge so long as the “tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.”]

[The Court reaffirmed an earlier case that] stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the “substantial nexus” required by the Commerce Clause.

*Id.*

requirements on issuers of credit card products that have very low minimum monthly payments, with the result that customers making only that minimum payment carry credit card debt over extended periods of time. The ABA brief discussed in detail the burdens, in terms of costs and additional service systems, that the California law imposed on out-of-state banks that provide credit cards in California.<sup>98</sup> This ABA brief was filed in addition to the principal briefs filed by the plaintiff banking associations and banks arguing that the California statute was preempted for federal banks and thrifts under the National Bank Act and the Home Owners Loan Act. The court held that the statute was preempted under these federal laws and granted injunctive relief to the federally chartered parties. The court's initial ruling did not address the Commerce Clause argument on behalf of state banks.<sup>99</sup> Soon after that ruling, the court issued an order granting the same injunctive relief to state banks, pending appeal, with the concurrence of the state Attorney General. This order tersely stated that the claim asserted under the Commerce Clause was moot.<sup>100</sup>

The result in the *Lockyer* case indicates that state banks can receive indirect benefits from federal preemption by piggybacking on a holding in favor of federal institutions. The court's unwillingness to rule on the merits of the Commerce Clause argument may have reflected a reluctance to open the door to Constitutional claims in the context of a consumer protection statute in banking. Despite this reluctance, the "negative" Commerce Clause remains a legal tool available to state banks operating in interstate markets.

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98. See Supplemental Memorandum of Points and Authorities in Support of Plaintiffs' Application for Preliminary Injunction, *American Bankers Ass'n. v. Lockyer*, (E.D. Cal. filed Nov. 8, 2002) (CIV. S-02-1138 FCD (JFM)) ("Negative commerce clause" analysis) (on file with NCBI). This brief did not attempt to argue that Riegle-Neal and § 104 might also support parity for state banks. See *id.*

99. See Memorandum of Points Order, *American Bankers Ass'n. v. Lockyer*, (E.D. Cal. filed Dec. 23, 2002) (CIV. S-02-1138 FCD (JFM)) (order granting preliminary injunction) (on file with NCBI). Subsequently, the state decided not to pursue its appeal.

100. *Id.*

## VII. STATE APPROACHES

The focus of states is naturally within their borders, with respect to both the integrity of state laws and institutions in the federal system and the terms of competition in banking within the state. The perception that the recent OCC preemption actions represent a significant new restriction on the ability of state authorities to enforce laws within their borders is fueling the current preemption controversy.

Federal preemption and the ability of the OCC to expand the activities of national banks of course have long been sensitive issues at the state level, and states have reacted in a variety of ways. With respect to powers, a number of states enacted so-called “wild card” statutes to provide a mechanism for state banks to exercise powers permitted to national banks that were not expressly authorized in state law. The response of state banking officials to the enactment of Riegle-Neal I is a further and more significant example of innovation in the dual banking system. After initially seeking to retain each state’s jurisdiction over out-of-state institutions in Riegle-Neal I, state bank officials and CSBS realized that the strength of the state system as a whole required each state to give up in practice “host state” authority by allowing each home state banking department to be the primary regulator, supervisor and examiner of the interstate state banks operating under its charter. Through their cooperative agreements and advocacy of Riegle-Neal II, the state bank regulators have embraced the home state export model as the means to develop a state system that substantially parallels and is a genuine alternative to the national system.

### A. *State Wild Card Statutes*

In an era in which the activities of national banks and federal thrifts are permitted to engage in steadily, if incrementally, has expanded through federal regulation and agency interpretation, the states have enacted general parity statutes that allow for parallel expansion of state bank activities without the need for specific legislative action (although specific regulating

action is often required). These so-called “wild card” statutes vary in their specifics, but generally provide for state banks to be able to match national bank, and in some cases federal thrift, activities. Although these statutes are directed at intrastate competitive parity with national banks, it is possible that in combination with § 104 and in light of the CSBS cooperative agreements, a state wild card statute might be interpreted to allow an out-of-state bank to operate under a home state law that parallels the host state law rather than be required to comply with host state law.

## *B. CSBS Initiatives*

### 1. CSBS Innovative Approach

In recent years, the state banking regulators, under the leadership of the CSBS, have charted a course that gives the primary regulatory role to each home state banking department over the activities of its state banks, including their branches and trust activities in host states. This framework, however, has not been extended to include state bank operating subsidiaries. State banking regulators now generally appreciate the importance of minimizing, if not eliminating, state-by-state regulatory burdens and barriers so that a state banking charter will be attractive. These regulators have taken the unusual step of effectively curbing their jurisdiction as host state regulators to enhance the state system as a whole.

State banking regulators acting collectively through CSBS and individual states have taken actions to provide a parallel legal framework and policies that recognize the need for state banks in practical terms to be able to operate with parity vis-à-vis federal institutions. In the wake of Riegle-Neal I, CSBS took the lead in the enactment of the 1997 Amendments to the Riegle-Neal Act and supported federal parity.

At the same time, the state bank regulators through CSBS adopted a multi-state agreement concerning the supervision and examination of multi-state state banks which recognizes the “first-



among-equals” role of the home state banking department.<sup>101</sup> State bank regulators recognize the need for multi-state cooperation so that state banks will be able to operate efficiently, seamlessly, and without undue regulatory burden on a multi-state basis.<sup>102</sup> However, state attorneys-general and other state departments have not been party to these agreements and are more likely to continue to enforce state laws under their jurisdiction by their terms.

## 2. Post-Riegle-Neal Cooperative Agreement

The Agreement concerns the operation and supervision of multi-state state banks and has been agreed to by all of the individual state banking departments. Through that agreement, CSBS sought to ensure the competitiveness of state banks in the interstate banking/branching environment by establishing the primacy of home state law in all instances in which the NB Act applies for national banks.<sup>103</sup> Home state law will be applied in all areas in which state law is pre-empted by the NB Act, including with respect to the “Big Four” — consumer protection, CRA, fair lending, and intrastate branching.<sup>104</sup> The adoption of this

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101. CONFERENCE OF STATE BANK SUPERVISORS, *Nationwide Cooperative Agreement* (1997), *available at*, [http://www.csbs.org/government/agreements/pdf/nationwide\\_coop\\_agrmnt.pdf](http://www.csbs.org/government/agreements/pdf/nationwide_coop_agrmnt.pdf) (last visited Feb. 7, 2004) (on file with NCBI).

102. *Id.*

103. *Id.*

104. Section 6 of the Agreement states:

The parties recognize that neither home nor host state supervisors may be empowered to waive provisions of home or host state law directly applicable to multi-state banks or their branches in host states. To the extent it may assist counsel and judicial authorities in resolving issues of applicable law, however, the parties agree that those issues may be resolved using the following general principles.

### Section 6.1. Host State Law.

Host state law that applies to the operations of a branch established in the host state by an out-of-state national bank, shall apply to the operations of a host state branch of a multi-state bank, including: (i) antitrust law and deposit concentration limits; (ii) community reinvestment and similar laws; (iii) consumer protection laws, including lending and usury laws to the extent that laws or court decisions regarding the exportation of interest rates are inapplicable; and (iv) fair lending or equal credit laws. . . .

Agreement and the acceptance of the role of home state law and supervisors as the primary point of contact for interstate banking activities should substantially reduce, but probably not eliminate, the risk that a state bank regulator would seek to apply a host state law to a state bank that would not apply to a national bank. And, of course, in a particular case a state supervisor may take a narrower view of the scope of national bank preemption than the OCC.

### 3. Trust Agreement

CSBS in recent years has been expanding its multi-state programs into trust activities (an area in which historically each state's law was regarded as broadly applicable to all providers, federal and state), again in response to OTS and OCC initiatives to provide an interstate trust regime based on federal law. CSBS seeks to ensure that state trust companies will be able to provide trust products and services from a home state platform on a multi-state basis. A Multi-State Trust Cooperative Agreement has now been agreed to by almost all the state bank regulators.<sup>105</sup> This Agreement and related procedures provide for the home state banking department to play a leading, pro-active role with other state departments to address and resolve host state legal and compliance matters.

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#### Section 6.2. Home State Law.

To the extent that, based on the principles referred to in Section 6.1, host state law is determined to be inapplicable to particular operations of a host state branch of a multi-state bank, such operations shall be governed by home state law. In addition, home state law shall apply generally to the corporate structure and procedures and internal policies of a multi-state bank including: (i) charter and bylaws; (ii) incorporation and dissolution; (iii) board of directors and management; (iv) capital; (v) loans and investments; (vi) common trust funds; (vii) dividends; (viii) indemnification of directors and officers; (ix) stock and debt; and (x) structure of bank subsidiaries.

CONFERENCE OF STATE BANK SUPERVISORS, Nationwide Cooperative Agreement, *supra* note 101.

105. See CONFERENCE OF STATE BANK SUPERVISORS, Nationwide Agreement for Supervision and Examination of Multi-State Trust Operations, *available at*, [http://www.csbs.org/government/agreements/html/nationwide\\_agrmnt\\_multi-state\\_trust\\_op.htm](http://www.csbs.org/government/agreements/html/nationwide_agrmnt_multi-state_trust_op.htm) (last visited Feb. 13, 2004) (on file with NCBI).

#### 4. CSBS Profile

In addition, in its *Profile of State Banking (the "Profile")* compendium, CSBS staff has been promoting practical uniformity by surveying state banking departments to determine the nature and scope of each state's law, as applied, on a wide – and expanding – range of topics, such as branching, nonbanking activities, trust activities, etc. The *Profile* is intended to encourage greater substantive uniformity and be a snapshot resource for identifying particular state laws that may raise issues for multi-state providers.

#### 5. A Work in Progress

As impressive as these developments are, they are quite recent and thus have not had time to produce a nationwide system without potential gaps for state banks. Moreover, CSBS has not undertaken to extend this framework to state bank operating subsidiaries. Together with the state and federal law discussed above, the CSBS system provides state regulators necessary tools for fostering a seamless multi-state system. It is particularly important that CSBS and its member banking commissioners have agreed that a bank's home state banking regulator should take the lead vis-à-vis other state regulators and be directly involved in the development of an appropriate and competitive multi-state compliance arrangement that is workable.

#### 6. 2003 Initiative by CSBS to Amend § 105 of Riegle-Neal

Targeted federal amendments are also part of the CSBS agenda. In 2003, in response to a proposal by the Texas Banking Department to adopt a state rule providing for assessment and examination of out-of-state branches, CSBS proposed an amendment to § 105 of Riegle-Neal to enhance home state bank regulatory authority over multi-state state banks. This proposal was adopted as section 619 of H.R. 1375, the Financial Services Regulatory Relief Act of 2003, at the mark-up by the full House

Financial Services Committee on May 20, 2003.<sup>106</sup> That bill has yet to be reported to the House floor.

The original Riegle-Neal Act gave host states authority over state bank interstate branches in those states. § 105 (codified at 12 U.S.C. § 1820(h)) provides the host state regulator with authority to examine host state branches for compliance with host state banking, consumer protection, fair lending, and community reinvestment laws, and laws governing permissible activities. The host state also may examine to ensure that branch activities in the host state are conducted in a safe and sound manner. It is silent with respect to the ability of a host state to levy fees on branches of out-of-state banks. This provision allows enforcement actions by the host state banking agency (or other host state authorities) for violation of applicable host state law.

The amendment proposed in 2003 is intended to conform § 105 to Riegle-Neal II. It states the general rule that the home state regulator is the overall regulator, supervisor, and examiner of state banks, including their host state branches. It also states that state bank regulators will act in accordance with the terms of cooperative agreements and thus gives statutory force to the Cooperative Agreement entered into by the state banking department. It also expressly states that only a home state may levy fees or assessments, unless otherwise specifically provided by cooperative agreement.

With respect to examination, the amendment retains the ability of host states to examine for compliance with host state consumer protection, fair lending or community reinvestment provisions to the extent they are applicable under the Riegle-Neal II parity provisions. A host state would have safety-and-soundness examination authority over host state branches only if the bank were determined to be in a “troubled condition” (CAMELS 4 or 5). A host state must provide notice to the home state before initiating any examination and all examinations must be conducted

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106. Section 619 of the Financial Services Regulatory Relief Act of 2003, H.R. 1375 (May, 20, 2003), *available at* <http://financialservices.house.gov/media/pdf/108fchr1375am1a.pdf> (last visited Feb. 13, 2004) (on file with NCBI). Section 401 of the bill also includes amendments to facilitate interstate trust activities by state institutions.

in accordance with a cooperative agreement. A host state would be able to initiate an enforcement action for violation of a host state consumer protection, fair lending, or community reinvestment law if it is applicable to the state bank branch under Riegle-Neal II.

This amendment is an example of the incremental steps that can be taken to provide a state banking system that parallels the national bank system, with the chartering agency, the home state banking department, in a functionally parallel position to the OCC. Although this proposal gives a greater role to host states than is the case for national banks, it would provide substantial parity for state banks operating on an interstate basis.

#### 7. Limits Flowing from Jurisdiction of Other State Agencies

In most states, agencies of state government other than the banking department (including the Attorney General) have jurisdiction over financial activities, such as lending activities conducted by all providers except as expressly excluded. While there are often express exceptions for home-state banks, national banks, and perhaps federal thrifts, the list of exceptions rarely includes insured banks chartered by other states, even though such banks are subject to the same federal rules and a parallel state regime in their home states. In contrast to contemporary banking departments, these other state agencies still tend to think in terms of their single state jurisdiction, not of a cooperative state system.

For bank activities, one or more parts of the legal framework should support a conclusion in favor of applying home-state law so that there is federal parity, in which a host state agency could concur. The bank's position can be bolstered by a supportive home-state banking department that can attest that its supervision and examination lead to a substantively parallel result to the one sought by the host state. A host-state banking department supportive of applying home-state law also might be helpful.

### VIII. POSSIBLE ACTIONS FOR MAINTAINING BALANCE IN THE DUAL BANKING SYSTEM

All banks have a stake in a strong dual banking system that provides the financial system with the strength and innovation that comes from a diversity of institutions and parallel regulatory regimes pursuing common goals of safety-and soundness, consumer protection, and operational efficiency. Such a system also provides each bank with a meaningful choice of charters and encourages all regulators to remain lean and responsive as they pursue their statutory missions. A strong dual banking system requires a critical mass of institutions in each system to provide the political and financial foundation for the regulatory structure on each side. In the last decade, the consolidation of state and national bank affiliates into interstate banks under a national bank charter has significantly eroded the institutional base in a number of states. The importance of the further development of federal preemption to national banks and the OCC has added to an apparent tilt in the national bank direction and fostered reluctance by banks to appear to be supporting the state side of the dual banking system.

To maintain the strength of the dual banking system, it should be possible to build on the existing statutory foundation to ensure that state banks have substantially the same ability as national banks to operate under a uniform legal and regulatory framework based on their charter law. This, of course, is no small task and involves the effective use of the resources of existing state and federal supervisors of state banks, the roles of these federal and state regulators in resolving specific “applicable law” issues, and mechanisms to prevent “competition in laxity” by any home state. The following are examples of initiatives that could be taken with regulatory agencies, particularly the FDIC, in litigation and in carefully tailored legislative amendments that do not open up a Pandora’s box of broader issues and concerns.

#### A. *FDIC Rulemaking*

For example, one or more state banks might petition the FDIC to use its rulemaking authority under 12 U.S.C. § 1831a(g)

to adopt a rule concerning federal preemption for the benefit of state banks that would parallel rules adopted by the OCC and OTS generally describing preemption for national banks and federal thrifts. An FDIC rule adopted in a notice-and-comment rulemaking implementing the statutory provisions discussed above should receive *Chevron* deference if subjected to judicial review.

*B. Amicus Briefs*

Briefs on behalf of state-chartered institutions might be filed in cases in which federal institutions are asserting that state statutes are preempted. Using arguments based on Riegle-Neal II and § 104, as well as the commerce clause, states banks can provide courts with federal statutory arguments supporting parallel relief. Judicial gloss would give state banks greater certainty about the scope of these federal statutes.

*C. Targeted Amendments*

An example discussed above is the CSBS amendment revising § 105 of Riegle-Neal to clarify the primacy of the home state regulator and to limit the ability of host states to examine or impose fees on out-of-state state banks that have branches in that host state. That amendment would supplement Riegle-Neal II, which addressed only applicable law. There are other state bank provisions enacted in the 1994 statute that might be amended to conform to the parity under home state law policy of Riegle-Neal II, without in any way undercutting the potential scope of Riegle-Neal II.

*D. Dual Banking System Working Group*

Given the inevitable limited resources, an ad hoc working group of state and national banks and trade associations could help identify opportunities, set priorities and provide resources for a concerted set of actions directed to maintaining the existing competitive balance in the dual banking system.

Genuine charter choice in the dual banking system has been a fundamental feature of the U.S. banking system. The dynamic at the heart of the dual banking system has been functionally important in the development of both modern banks and state and federal regulatory agencies that are flexible and responsive as they pursue their safety-and-soundness, consumer protection and other missions. The challenge now to bankers and regulators alike is to complete the modernization of the dual banking system in the present interstate banking environment and thus preserve its historic and valuable function.



