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“Preemption and the Evolving Business of Banking”

Good morning. I’m honored to be here, and it is a particular pleasure to have an opportunity to re-connect with many good friends in the New York banking community.

The New York Bankers Association has a proud history – which it is currently upholding under Mike Smith’s fine leadership – and the New York State banking system and New York State Banking Department have played a vital role in the development of the banking business and bank regulatory systems throughout the nation. Indeed, when the original version of the National Bank Act was crafted by Congress in 1863, many important features of the Act were drawn from provisions of the New York State banking law. So, I think it is particularly appropriate that this meeting of the New York Bankers Association provides an opportunity to talk about the evolution and future of our financial services markets, relative to the fundamental character of the national bank charter – and preemption.

In doing this, I particularly want to set the record straight regarding the nature, and the consequences of our recent preemption regulations. We are not surprised that they are controversial in some quarters; we are surprised at how much they have been misunderstood and mischaracterized. I’m going to take a crack at correcting some of that this morning.

Let me begin with some perspectives on the financial services environment and then link that to why we adopted our new preemption regulations.

I don’t have to tell you that today’s financial services markets are vastly different from the markets bankers confronted twenty, or even ten years ago. These changes have affected both the types of products that may be offered and the geographic region in which banks – large and small – may conduct business.

Many legal barriers to geographic expansion have been eliminated by Congress, or simply eroded by market developments. Advances in data analytics and communications, and changing customer demographics also have profoundly changed the business of banking. Consumers can shop for financial products and services on-line and can initiate financial transactions over the Internet, regardless of where they, or their bank, are located. Banks use technology to make

available a wider array of products and services and to deliver those products and services more quickly than ever before.

Credit decisions – approving a mortgage loan, applying for a credit card – that used to take weeks, can now be made through centralized scoring systems, in a matter of hours, maybe minutes, for a customer across your desk or across the country. Consumers also are increasingly mobile and they look to be able to take with them financial relationships that they have established, whether they are moving across the country or vacationing or retiring to Florida.

These developments highlight the increasing anomaly of applying geographically-based regulatory standards to markets for credit, deposits, and other financial services that are regional, national, and sometimes international in scope. Markets, in other words, are not divisible based on State or county lines, nor do they begin and end at the city limits.

Yet, the trend at the State – and sometimes even local – level has been to perpetuate, and even to enact more laws that localize – some would say “Balkanize” – bank regulation. While the objectives of these laws may be laudable, the result is that the same activity, conducted by the same entity, can be subject to an assortment of different standards, based on the location of a customer, or of the regulated event.

New York State has seen its own intra-state Balkanization experience in this regard in connection with New York *City's* initiative to apply a City predatory lending law. The New York Bankers Association participated in litigation challenging that law, arguing ably and successfully that various Federal and State laws preempted the City law. I must note here that New York *State* also argued that the City law was preempted not only by State law, but also, with respect to national banks, by provisions of the National Bank Act. The lesson here, I suppose, is that the topic of preemption is not without irony!

In any case, for bankers that want to serve existing customers or reach new customers in multi-state metropolitan areas, or in regional or national markets, regulation based on geography can result in a maze of inconsistent restrictions and requirements, regulatory overlaps and gaps. This multiplicity of regulation can limit product offerings, materially increase operating expenses and reduce the efficiency with which banks do business. And this is not an issue for banks alone. Product restrictions, higher operating expenses and inefficient operations translate into higher prices for bank customers and reduction in product selection.

Moreover, efforts to apply State and local bank regulation to national banks run headlong into the fundamental character of the national bank charter. National banks are designed to exercise uniform powers granted under Federal law, under consistent, national standards of operation, and uniform Federal administration of those standards. These characteristics take on heightened significance in view of the evolution of the banking business that I've just described.

Yet, increasingly, national banks were being confronted by assertions that various State and local restrictions and regulatory directives were applicable to their operations. Questions of preemption of these laws were growing in number. For several years, we dealt with those issues

on a case-by-case basis. Then we finally concluded that more definitive, effective clarification was needed.

In January of this year, we finalized two rules – our preemption rule and amendments to our existing visitorial powers rule – intended to provide national banks with the guidance they need to operate under uniform, predictable, nationally-applicable Federal standards – plus rigorous principles of consumer protection.

The preemption rule adds provisions to our regulations expressly addressing the applicability of certain listed types of State laws to national banks' lending and deposit-taking activities. Some have called this new rule a “dramatic,” “revolutionary,” or “breathtaking” enhancement of preemption for national banks. Some have said that, by adopting the rule, the OCC will “demolish” the dual banking system. These characterizations of the rules – and some associated characterizations of our motives in adopting them – are far off the mark.

The new regulation only preempts the types of laws listed in the rule. They are laws that are already preempted under longstanding, preexisting OCC regulations, that have been found to be preempted in OCC preemption determinations, that have been found to be preempted by the courts, or that have been determined to be preempted for Federal thrifts by the OTS. In other words, they were the types of laws for which there was substantial precedent recognizing the interference they posed to the ability of Federally-chartered institutions' to operate under uniform Federal standards. We will continue to evaluate other types of laws, not listed in the regulations, on a case-by-case basis, as we did before, under the pre-existing, judicially-established standards of federal preemption.

We could have continued issuing individual preemption opinions and litigating individual preemption cases involving State laws. But what purpose is served by requiring banks to ask the same question over and over? What purpose is served by forcing bankers to litigate the same issue again and again? What purpose is served by forcing them to incur the extra costs of those efforts? What is accomplished by delaying clarifying what standards apply to their operations?

We thought that the precedents and application of preemption principles were clear, and that inclusion of the listed laws in a regulation would provide certainty for bank operations. We make no apology for striving for an efficient, consistent, predictable – and rigorous – regulatory environment for national banks. In fact, we think that is our *responsibility*.

Moving to our second regulatory action, we amended our existing regulation concerning the OCC's exclusive “visitorial powers” with respect to national banks. “Visitorial powers” is a term used to refer to the authority to examine, supervise, and regulate the affairs of a corporate entity. Federal law specifically provides that “no national bank shall be subject to any visitorial powers except as authorized by federal law, vested in the courts of justice” or exercised by Congress or a committee of Congress.

This provision, which was *originally enacted in 1863*, is integral to the character of the national bank charter and is important today for national banks with multi-jurisdictional operations because it allows them to conduct their banking business subject to consistent Federally-

administered standards and uniform supervision of their banking business, wherever in the nation they operate. Despite all the rhetoric you have undoubtedly heard, *State Attorneys General – including your own – do not dispute that this Federal law prohibits them from examining or taking action administratively against national banks, such as through cease and desist proceedings.*

Its also important to note here that various Federal laws *do authorize* State authorities to regulate and/or take enforcement actions against national banks and their subsidiaries in a number of areas; securities, insurance, “do not call” lists and telemarketing sales practices, and enforcement of the Fair Credit Reporting Act are examples.

Thus, without getting into legal technicalities, our differences with State officials in connection with this rule change can be distilled to two issues: In matters where Federal law *has not authorized State authorities to bring lawsuits against national banks*, may State officials bring suit against national banks to accomplish regulatory and enforcement purposes that they acknowledge they cannot accomplish directly through administrative actions? And, for matters where *authority is not provided for them under Federal law*, may State officials regulate and take actions against national bank *operating subsidiaries* in connection with activities those subsidiaries are authorized to conduct under Federal law?

These questions illustrate that our position on “visitorial powers” has a discrete and identifiable scope of potential impact. Clearly, it does not entail the OCC “taking over” a vast domain of supervisory and enforcement activity directed at national banks that some assert has historically been performed by the States.

Yet, this image of a sweeping shift of responsibilities from the States to the OCC has lately been used as a springboard for assertions that the OCC lacks the resources to shoulder what is being portrayed as substantial new responsibilities taken over from the States. In essence, the argument being made is that the OCC lacks the commitment to consumer protection, or the necessary resources, or both, to handle the extensive new responsibilities it has stripped from the States, and that in order to assure that customers of national banks are adequately protected against abuses, State as well as Federal consumer protection laws must apply to national banks, and State as well as Federal enforcers must apply them. We profoundly disagree. First, as I described at the outset of my remarks, our regulatory actions were based on substantial precedent and are hardly “breathhtaking.” in scope or impact. Second, to hear the arguments advanced, you would never guess that the OCC has a long and credible track record of consumer protection activity.

We were the first federal banking agency to conduct regular, separate, full-scope consumer examinations, using specially-trained consumer examination specialists, and to produce consumer examination manuals and policy guidelines for bankers. That was in 1976.

Also in 1976, we implemented a consumer complaint information system to track complaints systematically. That early attempt to assemble a consumer database has evolved into our

Customer Assistance Group (the “CAG”), headed by our Ombudsman, who reports directly to the Comptroller.

Where we have found that national banks have engaged in abusive practices, we have not only acted with dispatch to end those practices, but have also used every legal and supervisory tool available – and have developed new tools -- in order to secure restitution to consumers and penalize the institutions involved.

We have pioneered the use of section 5 of the Federal Trade Commission Act as a basis to take enforcement action where we found instances of unfair or deceptive practices by national banks.

We have thwarted payday lenders in their “rent-a-charter” designs to use national banks as a cover for evading state consumer protection laws.

We have taken the lead in raising concerns about abusive practices in connection with so-called bounce protection products and in urging the other federal banking agencies to adopt standards to address those practices.

And we have issued the most comprehensive supervisory guidance ever issued by any federal banking agency, defining and describing predatory lending and warning banks about the supervisory consequences of engaging, directly or indirectly through purchased or brokered loans, in such practices.

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

I should add that if and when we do find problems affecting consumers, we have formidable authority to take corrective action – no ifs, ands, or buts. We don’t need to go into court; and we don’t need additional authorization or documents. We can take that action even when the bank has offices in many different States and in a single action we can obtain remedies for customers in every State.

Our new regulation strengthens this already impressive authority, for it contains two new provisions that expressly forbid abusive or predatory lending practices. The first prohibits national banks from making any consumer loan based predominantly on the foreclosure or liquidation value of a borrower’s collateral, rather than on the borrower’s ability to repay the loan – a provision that strikes at the heart of predatory lending. The second provides that national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act – an addition that seemed appropriate inasmuch as the OCC

pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct.

So, if you recently heard assertions that the OCC handles its consumer compliance responsibilities solely through a 40-person staff at our Customer Assistance Group located in Houston, those statements are just plain wrong. The CAG provides direct assistance to customers of national banks and their subsidiaries to resolve individual complaints, and it employs state-of-the art technology to help resolve matters with banks promptly. It also collates and disseminates complaint data that point our examiners to banks, and bank activities, that require further investigation and transaction testing. While the CAG is an important supplement to our compliance supervision functions, it is by no means all there is to it.

On behalf of our Ombudsman, today I extend – indeed repeat – an invitation to State banking supervisors and State Attorneys General, to visit the CAG and learn how the CAG operates, and hear from us how we handle consumer compliance supervision. *Come and learn what we do and how we operate; then, let's talk.*

I offer this information and invitation not to brag – although we are very proud of our record here – but to be clear about our commitment consumer compliance and the resources we have available to do our job. This foundation is vital to set the stage for some more constructive next steps with State authorities; it is also vital for national bank customers to know.

On the first point, we are hopeful that a constructive dialogue can emerge with State officials. It has never made sense to us that the OCC and the states would be locked in some kind of competition to supervise the same institutions when supervisory and enforcement resources are so dear, and, as a result, so many institutions – overwhelmingly nonbanks that probably need it most – may be effectively under-supervised. So let me renew the call to discuss ways in which we and State authorities can better cooperate on consumer issues – exchanging information on complaints, creating more effective mechanisms to ensure that complaints wind up in the hands of the authorities best positioned to take swift and effective action against offenders, identifying systemic problems, and enhancing transparency about how customers' problems are resolved.

I believe the OCC took an important step in that direction in our recent Advisory Letter concerning how national banks and their subsidiaries should handle consumer complaints forwarded by State authorities. We made clear that a complaint forwarded by a State official for resolution did not constitute an illegal “visitation” under the National Bank Act, and that national banks should not cite the OCC's exclusive visitorial power as a justification for not addressing the complaint. Nor should they resist a request from the referring State agency for information on how the complaint was resolved.

We also described how States may refer consumer issues concerning national banks to the OCC, including directly to my office, and the special procedures we have set up to handle and track these referrals. By coordinating our resources and working cooperatively with the States, we are convinced we can maximize benefits to consumers, close gaps between existing consumer

protection laws, and most effectively target financial predators. We welcome further dialogue with the States to explore these goals.

I must also tell you candidly that I am personally troubled by any effort to use preemption as a shield to avoid promptly responding to customers' concerns. That doesn't mean that the customer is always right. It does mean addressing their problem and giving them an answer. Failure to do so is not just bad customer relations; it endangers the hard-fought benefits of the national charter, and plays directly into the hands of those who will see such behavior as proof that banks require more aggressive, more intrusive regulation, and more regulators to watch over them. Surely that's not the outcome you want.

And that brings me to the second reason why accurate information on the OCC's approach and the OCC's resources is important – and to my final comment. Your program says our topic this morning is “Perspectives on the Future of the Financial Services Industry.” Whether your future will be robust or not depends on your ability to attract and retain *customers* – wholesale and retail, commercial and individual.

Customers of national banks deserve to know that the OCC expects national banks' business practices to reflect high integrity and high standards of customer treatment, and that the OCC stands ready with the commitment and the resources to make that expectation a reality. These expectations are goals all bankers should share. The market developments I discussed at the beginning of my remarks should be reason enough. While they enable bankers to offer products and services to more customers in more places; these developments also make it easier for them to leave you for another provider that gives them better treatment.

Many, many banks, in fact, are exemplary in their approaches to customer relations and resolution of customers' problems, and many have stepped up to the plate to improve their practices. But, in closing, for those that have not gotten the message, let me be clear; get with it. We will be watching, we will be there, and we care.